No. 12080

United States
Court of Appeals
for the Ninth Circuit

BASALT ROCK CO., INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Transcript of Record

Petition to Review a Decision of The Tax Court of the United States

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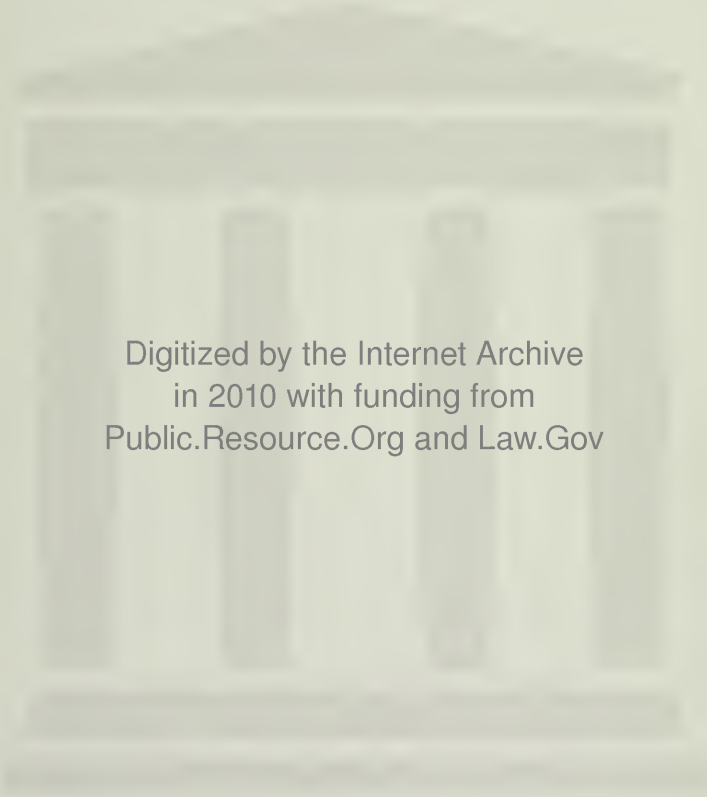

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INDEX

[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

APPEARANCES

For Taxpayer:

ANSON HERRICK, Esq.,
L. W. WRIXON, Esq.,
SIGVALD NIELSON, Esq.,
HARRY R. HORROW, Esq.

For Respondent:

LEONARD RAUM, Esq.,
R. C. WHITLEY, Esq.

Docket No. 10620

BASALT ROCK CO., INC.,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DOCKET ENTRIES

1946

Apr. 22—Petition received and filed. Taxpayer notified—fee paid.

Apr. 22—Request for hearing at San Francisco filed by taxpayer. 4/29/46 granted.

Apr. 23—Copy of petition served on General Counsel.

June 4—Answer filed by General Counsel.

June 5—Copy of answer served on taxpayer. San Francisco, Calif.

1946

Aug. 27—Motion for leave to file amendments to petition, amendments lodged, filed by taxpayer. 8/30/46 granted.

Sept. 4—Copy of amended petition served on General Counsel.

Sept. 23—Answer to amendments to petition filed by General Counsel. 9/25/46 copy served.

Oct. 4—Hearing set 12/2/46 at San Francisco, Calif.

Dec. 13—Hearing had before Judge Van Fossan on merits. Motion of taxpayer to file 2nd amendments to petition granted. Respondent to file answer to 2nd amendments to petition. Ordered continued to Washington, D. C. calendar (not to be set for 60 days from 12/13/46. Stipulation of facts filed at hearing. Motion to file and 2nd amendment to petition filed & served. Answer to 2nd amendment to petition filed & served.

Dec. 13—Order that motion be granted and proceeding be continued to Washington, D. C. calendar of 2/12/47 entered.

1947

Jan. 12—Transcript of hearing of 12/13/46 filed.

Feb. 12—Hearing had before Judge Van Fossan for further hearing. Ordered submitted. Stipulation of facts filed. Briefs due in 60 days—replies in 45 days.

Feb. 24—Transcript of hearing of Feb. 12, 1947 filed.

1947

Apr. 10—Motion for extension to May 14, 1947 for filing of petitioner's and respondent's brief and to June 30, 1947 for reply briefs, filed by General Counsel. 4/14/47 granted.

Apr. 11—Brief filed by taxpayer.

May 13—Brief filed by General Counsel.

May 14—Petitioner's brief served on General Counsel.

June 13—Joint motion for extension to Sept. 2, 1947 to file reply briefs filed. 6/16/47 granted.

Sept. 2—Reply brief filed by taxpayer. 9/3/47 copy served.

Sept. 2—Reply brief filed by General Counsel. [1*]

1948

Apr. 14—Opinion rendered, Disney J. Decision will be entered under Rule 50. 4/14/48 copy served.

June 9—Computation for entry of decision filed by General Counsel.

June 10—Hearing set July 7, 1948 on respondent's computation.

July 7—Hearing had before Judge Turner on settlement. Not contested. Referred to Judge Disney.

July 12—Decision entered, R. L. Disney, J. Div. 4.

Aug. 9—Motion to vacate decision filed by taxpayer.

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* Page numbering appearing at foot of page of original certified Transcript of Record.

1948

Aug. 27—Order vacating decision of July 12, 1948, entered.

Aug. 30—Decision entered, Disney J. Div. 4.

Sept. 29—Petition for review by U. S. Circuit Court of Appeals, 9th Circuit, with assignments of error filed by taxpayer.

Sept. 29—Proof of service filed.

Sept. 29—Notice of appeal with proof of service thereon filed by taxpayer.

Sept. 29—Designation of contents of record filed by taxpayer with proof of service thereon.

The Tax Court of the United States

Docket No. 10620

BASALT ROCK CO., INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE.

Respondent.

PETITION

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency dated January 25, 1946, bearing Bureau symbols IRA:90-D RR, and as a basis of its proceeding alleges as follows:

I. The petitioner is a corporation duly incorporated and existing under and by virtue of the

laws of the State of California. The principal office of petitioner is located at 8th and River Streets in the City of Napa, County of Napa, State of California. The United States corporation income and declared value excess profits tax return and the United States corporation excess profits tax return for the period here involved were filed with the Collector for the First District of California on or about March 15, 1943. [3]

II. The notice of deficiency (a copy of which is attached hereto and marked "Exhibit A" and made a part hereof) was mailed to the petitioner on January 25, 1946.

III. The tax in controversy is corporation excess profits tax for the calendar year 1942 and in the amount of $1,194,008.04. The Commissioner has determined a deficiency in excess profits tax for said year in the amount of $583,003.64, and the petitioner claims that there is an overpayment in excess profits tax for said year in the sum of $611,-004.40.

IV. The determination of tax set forth in said notice of deficiency is based upon the following errors:

(a) The respondent has erred in failing to allow petitioner a deduction in the amount of $35,-890.48, in arriving at its excess profits net income computed under the percentage of completion method, and in failing to allow petitioner a deduction in the amount of $10,440.54, in arriving at its net income for normal tax, surtax, and declared value excess profits tax purposes computed under

the completed contract method, for accelerated amortization of emergency facilities pursuant to the provisions of section 124 of the Internal Revenue Code.

(b) The respondent erred in increasing the excess profits net income of petitioner by the adjustment of income on contracts under the percentage of completion basis in the sum of $421,126.29 or any sum in excess of $211,209.81. [4]

(c) The respondent erred in determining that the petitioner's excess profits tax for the year 1942 is limited to an amount which, when added to the normal and surtax imposed on petitioner for said year, equals 80 per cent of the petitioner's surtax net income computed under the percentage of completion method and in failing to determine that the petitioner's excess profits tax for said year is limited under the provisions of section 710(a)(1)(B) of the Internal Revenue Code to an amount which, when added to the normal tax and surtax imposed on the petitioner for said year equals 80 per cent of the petitioner's surtax net income computed under the completed contract method in accordance with the provisions of section 15 of the Internal Revenue Code.

(d) The respondent erred in determining petitioner's excess profits tax under the provisions of section 710(a)(1)(B) of the Internal Revenue Code by allowing the petitioner a credit for normal tax and surtax under section 26(e) of the Internal Revenue Code in an amount equal to petitioner's adjusted excess profits net income computed under

the completed contract method, and erred in failing to determine said tax by allowing said credit under section 26(e) of the Internal Revenue Code in the amount of petitioner's adjusted excess profits net income computed under the percentage of completion method.

(e) In the alternative, in the event respondent correctly computed the credit allowable under section 26(e) of the Internal Revenue Code, respondent erred in failing to determine that the petitioner's excess profits tax for the year 1942 is limited to an amount which, when added to the normal tax and surtax [5] computed by allowing said credit under section 26(e) of the Internal Revenue Code, equals 80 per cent of the petitioner's surtax net income for the year 1942 computed under the completed contract method.

(f) The respondent erred in determining that there is a deficiency in excess profits tax due from petitioner for the year 1942 in the sum of $583,003.64 and in failing to determine that there is an overpayment by petitioner in excess profits tax for said year in the sum of $611,004.40.

V. The facts upon which the petitioner relies as the basis of this proceeding are as follows:

(a)(1) Pursuant to and in accord with the authority contained in seven certificates of necessity issued to petitioner (numbered 486, 2196, 2241, 3498, 5697, 7161, and 7646), petitioner acquired or constructed facilities having a total cost of $842,903.91. In accord with the requirements of section 124(d) of the Internal Revenue Code and sec-

tion 29.124-5(e) of respondent's Regulations 111, petitioner on December 17, 1945, and within ninety days after the date of the President's proclamation No. 2669, gave notice in writing to respondent that it (petitioner) elected to amortize the adjusted basis of the emergency facilities acquired and constructed pursuant to said seven certificates of necessity over the shortened period ended September 30, 1945, in lieu of the sixty-month period provided in section 124(a) of the Internal Revenue Code.

(a)(2) Amortization of the cost of said emergency facilities ($842,903.91) in accord with said election of petitioner [6] so made in writing on December 17, 1945, as aforesaid, results in a deduction for amortization in arriving at excess profits net income for 1942 in the amount of $35,890.48 in addition to the deduction for amortization heretofore claimed by petitioner in its excess profits tax return for said year, said sum of $35,890.48 being allocable as follows:

To additional cost of contracts completed in 1942		$ 10,440.54
To additional cost of contracts partially completed December 31, 1942		25,449.94
Contract No. 34	$ 13,143.09	
Contract No. 2310	8,940.32	
Contract No. 661	3,366.53	
Total		$ 35,890.48

Amortization of the cost of said facilities in accordance with said election of petitioner results in a deduction for amortization, in arriving at normal tax and surtax net income for 1942, in the sum of $10,440.54 in addition to the deduction for amor-

tization heretofore claimed on petitioner's income tax return for said year. In arriving at the deficiency involved in this proceeding, respondent erroneously failed to allow said additional amounts as deductions for amortization.

(b)(1) During the year 1942 and prior thereto, petitioner entered into certain contracts with the United States of America for the construction of various kinds of boats. The performance of each of said contracts required more than twelve months. Petitioner filed its United States corporation income [7] and declared value excess profits tax return for the year 1942 on a completed contract basis as to said contracts. However, petitioner filed its United States corporation excess profits tax return for the year 1942 on the percentage of completion method of accounting, pursuant to an election made by petitioner under and pursuant to the provisions contained in section 736(b) of the Internal Revenue Code. Petitioner's gross income in 1942 from contracts the performance of which required more than twelve months was in excess of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, thus satisfying the requirement of said section 736(b) for an election to report income for excess profits tax purposes on the percentage of completion method of accounting.

(b)(2) In petitioner's excess profits tax return for the year 1942, the petitioner included as gain or loss on a percentage of completion basis the fol-

lowing amounts in respect of certain contracts with the United States Navy:

Contract No. 34.....	Gain,	$380,101.24
Contract No. 2310.....	Gain,	331,327.26
Contract No. 661.....	Gain,	152,520.50
Contract No. 808.....	Gain,	499.66

In arriving at the deficiency involved in this proceeding, the respondent determined that the gain or loss in respect of said contracts for the year 1942 on the percentage of completion basis was as follows: [8]

Contract No. 34.....	Gain,	$357,934.08
Contract No. 2310.....	Gain,	442,144.31
Contract No. 661.....	Gain,	490,493.21
Contract No. 808.....	Loss,	4,996.65,

resulting in an increase in the amount of $421,-126.29 in the excess profits net income as determined by respondent over the amount resported by petitioner in its excess profits tax return in respect of said contracts.

(b)(3) The United States Navy determined the percentage of completion as of December 31, 1942, applicable to each contract which it then held with petitioner. The amount of additional income realized in respect of said contracts in excess of that reported by petitioner on its excess profits tax return for the year 1942 based on the percentages of completion as determined by the United States Navy is not in excess of the net amount of $211,-209.81 and not said amount of $421,126.29 determined by respondent as set forth on page 8, of

Exhibit A, attached hereto and made a part hereof. A statement covering the percentages of completion of said contracts as of December 31, 1942, and the amounts which petitioner alleges should be included in its excess profits net income in respect of said contracts is attached hereto, marked "Exhibit B," and made a part of this petition.

(c)(1) As heretofore alleged in paragraph V (b)(1) hereof, petitioner filed its United States corporation income and declared value excess profits tax return (form 1120) for the year 1942 on a completed contract basis and petitioner filed its [9] United States corporation excess profits tax return (form 1121) for the calendar year 1942 on the percentage of completion method of accounting pursuant to an election made under the provisions of section 736(b) of the Internal Revenue Code. In computing petitioner's excess profits tax for the year 1942, the respondent determined that the surtax net income for purposes of the 80 per cent limitation prescribed in section 710(a)(1)(B) of the Internal Revenue Code should be computed under the percentage of completion method and that said surtax net income was $2,404,571.73, of which 80 per cent was $1,923,657.38. The respondent determined that the petitioner's adjusted excess profits net income was $2,129,517.39 and that 90 per cent thereof was $1,916,565.65. Having determined that the petitioner's normal tax and surtax for the year 1942 was the amount of $71,655.21, the respondent determined that the excess profits tax of petitioner for the year 1942 was limited under section 710

(a)(1)(B) of the Code to the amount of $1,852,-002.17.

(c)(2) Petitioner alleges that its excess profits tax for the year 1942 is limited under the provisions of section 710(a)(1)(B) of the Internal Revenue Code to an amount which, when added to its normal tax and surtax for the year 1942, equals 80 per cent of its surtax net income for said year determined under the provisions of section 15 of the Internal Revenue Code on a completed contract basis, as follows:

Surtax net income	$912,061.67
80 per cent thereof	729,649.34
Less normal tax and surtax	71,655.21
Excess profits tax under section 710(a)(1)(B)	657,994.13

(d)(1) In computing the petitioner's excess profits tax for the year 1942, the respondent determined that the petitioner's normal tax and surtax for said year were in the amount of $71,655.21. Said taxes were based on an allowance of a credit of $729,257.76 for income subject to excess profits tax under section 26(e) of the Internal Revenue Code. For the purposes of said credit, respondent computed said income on the basis of the completed contract method.

(d)(2) Petitioner alleges that the income subject to excess profits tax for purposes of the credit under section 26(e) of the Internal Revenue Code should be computed without regard to the 80 per cent limitation provided in section 710(a)(1)(B) of the Internal Revenue Code and on the basis of the percentage of completion method. Said income

subject to excess profits tax for the purposes of said credit was in excess of petitioner's normal tax and surtax net income, and there is no normal tax or surtax liability for the year 1942. Petitioner's excess profits tax for said year is limited to the amount of $729,649.34 or 80 per cent of its surtax net income computed under section 15 of the Internal Revenue Code on the completed contract basis.

(e) In the alternative, in the event that the respondent correctly determined the credit allowable under section 26(e) of the Internal Revenue Code by using the completed contract method and that petitioner is liable to normal tax and surtax for 1942 in the total amount of $71,655.21, petitioner alleges that its excess profits tax liability for the year 1942 [11] should be computed by subtracting said normal tax and surtax liability from the aforesaid sum of $729,649.34.

(f) On or about the 16th day of April, 1945, petitioner filed form 843, claim for refund to petitioner of excess profits tax for 1942 in the sum of $530,996.76. A copy of said claim for refund in the amount of $530,996.76 is attached hereto, marked "Exhibit C," and by this reference is incorporated herein and made a part hereof. Petitioner alleges that it overpaid its excess profits tax for the year 1942 in the amount of $539,349.19, or in the event its normal tax and surtax liability for said year is $71,655.21, said overpayment is the amount of $611,004.40. A statement attached hereto, marked "Exhibit D," and by this reference incorporated herein and made a part hereof, sets

forth in detail the factors used in computing said overpayment of $539,349.19, or, in the alternative, $611,004.40. Petitioner paid excess profits tax for the year 1942 in the following amounts and on the following dates:

$334,000.00 on March 13, 1943;
$300,499.26 on June 15, 1943;
$317,249.64 on September 15, 1943; and
$317,249.64 on December 15, 1943.

Wherefore, petitioner prays that this court may hear this proceeding and determine that there is no deficiency in excess profits tax due from this petitioner for the year 1942; that there is an overpayment in excess profits tax due to petitioner for said year in the sum of six hundred eleven thousand four and [12] forty hundredths dollars ($611,-004.40), together with interest thereon as provided by law; and that the amount of said overpayment was paid within three (3) years from the date of the filing of the claim for refund thereof or from the date of filing this petition; and for such other relief as may be proper.

Dated: San Francisco, California, April 18, 1946.

/s/ ANSON HERRICK,
/s/ L. W. WRIXON,
/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
Counsel for Petitioner. [13]

JURAT

State of California,
County of Napa—ss.

A. G. Streblow, being first duly sworn, says that he is an officer, to wit, President of Basalt Rock Co., Inc., the Petitioner named in the foregoing and annexed Petition, and that as such officer he is duly authorized to verify said Petition; that he has read the foregoing Petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

/s/ A. G. STREBLOW.

Subscribed and sworn to before me this 12th day of April, 1946.

/s/ JOHN R. ANDERSON,
Notary Public in and for the County of Napa, State of California.

My commission expires 3/27/49. [14]

EXHIBIT A

(Seal) Treasury Department (Copy)
Internal Revenue Service
74 New Montgomery Street
San Francisco 5, California

Office of Internal Revenue Agent in Charge
San Francisco Division

IRA:90-D RR Jan. 25, 1946

Basalt Rock Co., Inc.
8th and River Streets
Napa, California

Gentlemen:

You are advised that the determination of your excess profits tax liability for the taxable year ended December 31, 1942, discloses a deficiency of $583,003.64 and that the determination of your income tax liability for the year mentioned discloses an overassessment of $174.33 as shown in the statement attached.

In accordance with the provisions of existing internal revenue laws, notice is hereby given of the deficiency or deficiencies mentioned.

Within 90 days (not counting Saturday, Sunday or a legal holiday in the District of Columbia as the 90th day) from the date of the mailing of this letter, you may file a petition with The Tax Court of the United States, at its principal address, Washington, D. C., for a redetermination of the deficiency or deficiencies.

Should you not desire to file a petition, you are

Exhibit A—(Continued)

requested to execute the enclosed form and forward it to the Internal Revenue Agent in Charge, San Francisco 5, California, for the attention of Conference Section. The signing and filing of this form will expedite the closing of your return(s) by permitting an early assessment of the deficiency or deficiencies, and will prevent the accumulation of interest, since the interest period terminates 30 days after filing the form, or on the date assessment is made, whichever is earlier.

Respectfully,

JOSEPH D. NUNAN, Jr.
Commissioner,

By /s/ F. M. HARLESS,
Internal Revenue Agent in Charge.

Enclosures: Statement, Form of Waiver, Claim.

STATEMENT

Tax Liability for the Taxable Year Ended December 31, 1942

	Liability	Assessed	Overassessment	Deficiency
Income Tax	$ 71,655.21	$ 71,829.54	$174.33	.....
Excess Profits Tax	1,852,002.17	1,268,998.53	.....	$583,003.64

The amount of $251,790.53 excess profits tax was claimed on the excess profits tax return as a deferment under section 710(a)(5) of the Internal Revenue Code pending consideration of application for relief under section 722. The records disclose

Exhibit A—(Continued)

that your application for relief under section 722 (form 991) for the taxable year was withdrawn prior to investigative action. The amount deferred is, therefore, included in the deficiency shown above.

In making this determination of your income and excess profits tax liabilities, careful consideration has been given to your protest dated April 12, 1945, to the statements made at the conference held on May 8, 1945; and to your claims for refund (Form 843) of income and excess profits taxes filed April 16, 1945.

If a petition to The Tax Court of the United States is filed against the excess profits tax deficiency shown herein, the issue set forth in your claim for refund of $530,996.76 excess profits tax should be made a part of the petition to be considered by The Tax Court in any redetermination of your excess profits tax liability.

If a petition is not filed, your claims for refund of $530,996.76 excess profits tax and $71,829.54 income tax will be disallowed, and official notice of the disallowance will be issued by registered mail in accordance with existing internal revenue laws.

The overassessment of $174.33, income tax shown herein will be made the subject of a certificate of overassessment which will reach you in due course through the office of the Collector of Internal Revenue for your district and will be applied by that official in accordance with section 322 of the Internal Revenue Code. You should, however, fully

Exhibit A—(Continued)

protect yourself against the operation of the statute of limitations with respect to the apparent overassessment by filing with the Collector of Internal Revenue for your district, a claim for refund on the enclosed Form 843, the basis of which may be as set forth herein.

A copy of this letter and statement has been mailed to your representative, Lester Herrick and Herrick, 465 California Street, San Francisco 4. California, in accordance with the authority contained in the power of attorney executed by you and on file in this office.

Adjustments to Net Income

Net income for declared value excess-profits tax computation as disclosed by return		$929,830.02
Unallowable deductions and additional income:		
(a) Unemployed tax	$1,053.67	
(b) Real estate tax	99.01	1,152.68
Total		$930,982.70
Nontaxable income and additional deductions:		
(c) Franchise tax	$ 630.54	
(d) Capital stock tax	3,750.00	
(e) Other adjustments	4,093.95	8,480.49
Net income for declared value excess-profits tax computation as adjusted		$922,502.21

Explanation of Adjustments

(a) The deduction for unemployment taxes is reduced by $1,055.67, since the proper accrual in accordance with your books of account and records is $18,579.95 instead of $19,633.62 claimed.

(b) The deduction of $99.01 for real estate taxes

Exhibit A—(Continued)

is disallowed. The taxes were a lien on the property when purchased and the amount of tax paid is, therefore, held to be additional cost of the prop-
is, therefore, held to be additional cost of the property.

(c) Additional deduction is allowed for franchise tax as shown below:

Net increase in prior year income	$ 15,362.16
Franchise tax restored to income	551.52
Total	$ 15.913.68
Additional franchise tax allowed (4% of $15,913.68)	636.54

(d) Additional deduction is allowed for capital stock as follows:

Value of capital stock as declared in your capital stock tax return for the year ended June 30, 1943	$20,000,000.00
Capital stock tax accrued at $1.25 per M	25,000.00
Amount claimed on your return	21,250.00
Additional capital stock tax allowed	$ 3,750.00

(e) Adjustments to income and expense were made on your books which were not reflected in the net income reported on your income tax return. As a result of the adjustments net income is decreased as follows:

Decrease:	
Accrued liability and compensation insurance (net)	$ 869.20
Errors and adjustments on contracts and other sales (net)	2,754.92
Sales tax adjustments, etc.	1,685.00
Total	$5,309.12
Increase:	
Sundry credit	$1,215.17
Net decrease	$4,093.95

Exhibit A—(Continued)

(f) The credit for income subject to excess profits tax allowable under section 26(e) of the Internal Revenue Code is computed in accordance with the provisions of section 35.736 (b)-3(a) and (c) of Treasury Regulations 112, as follows:

80% Limitation Rule

Surtax net income—completed contract basis (without regard to the credit under section 26(e))	$922,502.21
Maximum tax—80% of $922,502.12	$738,001.77
Less: Actual normal tax and surtax	71,655.21
Tax under 80% rule	$666,346.56

General Rule

Surtax net income—completed contract basis (without regard to the credit under section 26(e))	$922,502.21
Less: Net long-term capital gain	37,617.15
Excess profits tax income	$884,885.06
Excess profits credit as shown herein	155,627.30
Adjusted excess profits net income	$729,257.76
Tax at 90%	$656,332.00

Credit under Section 26(e)

Net income—completed contract basis	$922,502.21
Additions from prior years	0.00
Credit allowable (100/90 of $656,332.00, the lesser of the above taxe)	729,257.76
Credit claimed on return	$736,149.76

Computation of Declared Value Excess-Profits Tax

Net income for declared value excess-profits tax computation	$ 922,502.21
Less: 10% of $17,000,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1942	1,700,000.00
Amount subject to declared value excess-profits tax	$ 0.00
Declared value excess-profits tax assessable	0.00
Declared value excess-profits tax assessed	0.00

Exhibit A—(Continued)

Computation of Alternative Tax

Net income		$922,502.21
Less: Net long-term capital gain		37,617.15
Adjusted net income		$884,885.06
Less: (f) Income subject to excess profits tax		729,257.76
Balance subject to normal tax		$155,527.30
Amount subject to surtax		$155,627.30
Normal Tax:		
Adjusted normal tax net income	$155,627.30	
Normal tax at 24% on $155,627.30		$ 37,350.55
Surtax:		
Adjusted surtax net income	$155,627.30	
Surtax at 16% on $155,627.30		24,900.37
Partial tax (total normal tax and surtax)		$ 62,250.92
Plus: 25% of net long-term capital gain of $37,617.15		9,404.29
Alternative tax		$ 71,655.21

Computation of Income Tax

Net income for declared value excess-profits tax computation		$922,502.21
Less: Declared value excess-profits tax		0.00
Net income for capital stock tax purposes		$922,502.21
Less: (f) Income subject to excess profits tax		729,257.76
Normal tax net income		$193,244.45
Surtax net income		$193,244.45
Normal Tax Computation:		
Normal-tax net income	$193,244.45	
Normal tax at 24% on $193,244.45		$ 46,378.67

Exhibit A—(Continued)

Surtax Computation:		
Surtax net income	$193,244.45	
Surtax at 16% on $193,244.45		$ 30,919.11
Total normal tax and surtax		$ 77,297.78
Alternative tax		$ 71,655.21
Total income tax assessable (smaller tax)		$ 71,655.21
Income tax assessed:		
Original, June 1944 list, Account No. 410343—First California District		$ 71,829.54
Overassessment of income tax		$ 174.33

Adjustments to Excess Profits Net Income as Computed Under the Income Credit Method and Percentage of Completion Method

Excess profits net income under the percentage of completion method (section 736(b) of the Internal Revenue Code) as disclosed by return		$ 1,878,825.07
Additions:		
(a) Adjustment of income on contracts under percentage of completion basis	$421,126.29	
(b) Recoveries of bad debts	435.81	421,562.10
Total		$ 2,300,387.17
Deductions:		
(c) Nontaxable income from exempt excess output	$ 7,914.67	
(d) Net decrease in declared value excess-profits net income	7,327.81	15,242.48
Excess profits net income under the percentage of completion method (section 736(b) of the Internal Revenue Code) as adjusted		$ 2,285,144.69

Exhibit A—(Continued)

Explanation of Adjustments

(a) For income tax purposes your net income from long-term contracts is reported on the completed contract basis. However, for excess profits tax purposes election has been made to report excess profits net income from long-term contracts on a percentage of completion basis as provided in section 736(b) of the Internal Revenue Code.

In computing the income from certain contracts it is noted that the gain was computed on estimates based on costs instead of upon the method prescribed for percentage of work completed. Adjustment is, therefore, made of the income reported on these contracts, as follows:

Exhibit A—(Continued)

Contract No.	No. 34	No. 2310	No. 661	No. 808
Contract price (plus additions)	$ 7,077,646.47	$ 8,985,889.00	$15,117,548.16	$ 3,630,000.00
Percentage completed to date	58.7618%	42.0238%	13.3335%	.....
Amount completed to date	$ 4,158,946.47	$3,776,209.00	$ 2,015,698.16	$ 0.00
Costs to date	3,801,012.39	3,332,174.50	1,525,204.94	4,996.65
Correct gain (loss) to date	$ 357,934.08	$ 444,034.50	$ 490,493.21	($ 4,996.65)
Gain reported 1941	.....	1,890.19	.....	.....
Gain (loss) to be reported 1942	$ 357,934.08	$ 442,144.31	$ 490,493.21	($ 4,996.65)
Gain as reported on 1942 return	380,101.24	331,327.26	152,520.50	499.66
Adjustment	($ 22,167.16)	$ 110,817.05	$ 337,972.71	($ 5,496.31)
Net increase in excess profits net income				$ 421,126.29

Exhibit A—(Continued)

(b) The bad debt recoveries are not a proper exclusion from excess profits net income since you have established a reserve method of treating bad debts and the recoveries are held to be a credit to the reserve. The bad debt recoveries of $435.81, are, therefore, restored to excess profits net income.

(c) Nontaxable income from exempt excess output on rock quarry at Napa, California, was not claimed on the return. The nontaxable income under the provisions of section 735 of the Internal Revenue Code is determined as follows:

Production in base period years:		
1936	293,491	tons
1937	110,774	tons
1938	112,471	tons
1939	88,406	tons
Total	605,142	tons
Average normal output (continuous production during the base period)	151,285	tons
Output for 1942	400,972	tons
Excess output for 1942	249,687	tons
Estimated recoverable units	849,687	tons
Percentage (849,687 tons/249,687 tons)	29.3857%	
Percentage to be treated as exempt under section 735(a)(11) Internal Revenue Code	90%	
Exempt excess output for 1942 (90% of 249,687 tons)	224,718.3	tons
Normal unit profit per ton (during the base period)	$0.0352204	
Nontaxable income from exempt excess output (224,718.3 tons time $0.0352204)	$ 7,914.67	
Net income for 1942	$171,061.00	

Exhibit A—(Continued)

Unit net income for 1942—per ton ($171,061.00 divided by 400,972 tons)	$ 0.427
Net income attributable to excess output for 1942 (249,687 tons times $0.427)	$106,616.34
Nontaxable income from exempt excess output allowable ($106,616.34 or $7,914.67—smaller amount)	$ 7,914.67

(d) The net decrease in net income for declared value excess-profits tax computation is explained in the foregoing and consists of the following items:

Decrease—Franchise tax		$ 636.54
Capital stock tax		3,750.00
Other adjustments		4,093.95
Total		$8,480.49
Increase—Unemployment tax	$1,053.67	
Real estate tax	99.01	1,152.68
Net decrease		$7,327.81

Excess Profits Credit Based on Income as Computed on Percentage of Completion Basis

No change is made in the amount reported on the return.

Base Period Net Income:	As Reported
Year ended December 31, 1936	$ 60,195.47
Year ended December 31, 1937	48,602.19
Year ended December 31, 1948	41,232.27
Year ended December 31, 1939	206,440.34
Total	$356,470.27

Exhibit A—(Continued)

Base Period Net Income Increased Earnings in Last Half:	
Net aggregate, last half of period	$247,672.61
Net aggregate, first half of period	108,797.66
Excess, last half over first half	$138,874.95
50% of such excess	$ 69,437.48
Add: Net aggregate for last half	247,672.61
Total	$317,110.09
Average base period net income	$158,555.05
Excess profits credit (95% of $158,555.05)	$150,627.30

Computation of Excess Profits Tax

Excess profits net income		$ 2,285,144.69
Less: Specific exemption	$ 5,000.00	
Excess profits credit	150,627.30	155,627.30
Adjusted excess profits net income		$ 2,129,517.39
90% thereof		$ 1,916,565.65
Net income	$ 922,502.21	
Income on basis of percentage of completion per return $1,060,943.23		
Additional as shown herein	421,126.29	1,482,069.52
Surtax net income computed under section 710(a)(1)(B)		$ 2,404,571.73
80% thereof		1,923,657.38
Less: Income tax for taxable year (other than section 102)		71,655.21
Balance		$ 1,852,002.17
Excess profits tax: Above balance, or 90% of adjusted excess profits net income, whichever is the lesser amount		$ 1,852,002.17
Excess profits tax assessable		$ 1,852,002.17

Exhibit A—(Continued)

Excess profits tax assessed: Original, June 1943 list, Account No. 400309—First California District....	1,268,998.53
Deficiency of excess profits tax	$ 583,003.64

Post-War Refund of Excess Profits Tax and Credit for Debt Retirement

	Return	Corrected
Excess profits tax	$ 1,268,998.53	$ 1,852,002.17
Credit allowable under section 780 and 781	$ 126,899.85	$ 185,200.22
Net reduction in indebtedness under section 783	$ 0.00	
Credit for debt retirement allowable	0.00	0.00
Net post-war refund credit	$ 126,899.85	$ 185,200.22

EXHIBIT B

Statement Showing Determination of Additional Taxable Income for Excess Profits Tax Purposes

Description	Total	Contract Number 34	2310	661	808
1. Contract Price (per page 8, Exhibit A)	$34,781,083.63	$ 7,077,646.47	$ 8,985,889.00	$15,117,548.16	$ 3,630,000.00
2. Per Cent completed to Dec. 31, 1942 based on Reports from U. S. Navy	.....	57.7%	41.2%	13.1%	.....
3. Amount completed to Dec. 31, 1942 (line 1 times line 2)	9,766,387.09	4,083,802.01	3,702,186.27	1,980,398.81	.....
4. Costs to Dec. 31, 1942 per page 8, Exhibit A	$ 8,663,388.49	$ 3,801,012.39	$ 3,332,174.50	$ 1,525,204.95	$ 4,996.65
5. Accelerated Amortization claimed by Petitioner in addition to deduction taken or allowed in 1942	25,449.94	13,143.09	8,940.32	3,366.53	.....
6. Revised costs to Dec. 31, 1942 (line 4 plus line 5)	$ 8,688,838.43	$ 3,814,155.48	$ 3,341,114.82	$ 1,528,571.48	$ 4,996.65
7. Revised Gain to Dec. 31, 1942 (line 3 minus line 6)	1,077,548.66	269,646.53	361,071 45	451,827.33	(4,996.65)
8. Gain previously reported by Petitioner in 1941 and 1942, per page 8, Exhibit A	866,338.85	380,101.24	333,217.45	152,520.50	499.66
9. Add'l gain to be reported by Petitioner for 1942 (line 7 minus					

EXHIBIT C

Form 843—Treasury Department, Internal Revenue Service (Revised Oct. 1945)

CLAIM

To be filed with the Collector where assessment was made or tax paid.

The Collector will indicate in the block below the kind of claim filed, and fill in the certificate on the reverse side.

[x] Refund or Tax Illegally Collected.

[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.

[ ] Abatement of Tax Assessed (not applicable to estate, gift, or income taxes).

State of California,
County of Napa—ss.

Name of taxpayer or purchaser of stamps: Basalt Rock Company, Inc.

Business address: 8th and River Streets, Napa, California.

The deponent, being duly sworn according to law, deposes and says that this statement is made on behalf of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: 1st California.

2. Period (if for income tax, make separate form for each taxable year) from January 1, 1942, to Dec. 31, 1942.

3. Character of assessment or tax: Excess Profits Tax.

4. Amount of assessment, $1,268,988.53; dates of payment: Quarterly—1943.

5. Date stamps were purchased from the Government.....

6. Amount to be refunded: $530,996.76.

7. Amount to be abated (not applicable to income, gift, or state taxes).....

8. The time within which this claim may be legally filed expires, under Section 322 IRC on March 15, 1946.

The deponent verily believes that this claim should be allowed for the following reasons:

The taxpayer contends that Sec. 35.736(b)-3 of the Commissioner's Regulations 109 are invalid insofar as they require that taxpayer's electing to report income from long term contracts under the provisions of Section 736(b) of the Internal Revenue Code shall include income from long-term contracts upon a percentage method of accounting for the purpose of computing surtax net income under the provisions of Section 710(a)(1)(B). The taxpayer contends that its excess profits tax should be computed as shown in Statement A attached hereto and made a part hereof.

/s/ BASALT ROCK COMPANY, INC.
By .....

Sworn to and subscribed before me this.....
day of....., 19....

.....
(Signature of officer administering oath)

STATEMENT A

Basalt Rock Company, Inc.
Claim for Refund 1942

COMPUTATION OF NORMAL TAX:

Normal Tax Net Income—Before credit under Section 26(e)—per Revenue Agent's Report 2/19/45		$ 922,501.21
Net Income Subject to Excess Profits Tax		2,127,627.20
Excess Profits Net Income per Revenue Agent's Report 2/19/45	$ 2,283,254.50	
Less	155,627.30	
Specific Exemption $ 5,000.00		
Excess Profits Credit	150,627.30	
Balance Subject to Normal and Surtax		None

COMPUTATION OF EXCESS PROFITS TAX UNDER SECTION 710(a)(1)(B):

Surtax Net Income before deducting credit under Section 726(e), Revenue Agent's Report 2/19/45	$ 922,501.21
80%	$ 738,001.77
Normal Tax	None
Excess Profits Tax	$ 738,001.77
Excess Profits Tax assessed on basis of original return	1,268,998.53
Overpayment	$ 530,996.76

This claim was prepared by Fred H. Brown of the firm of Lester Herrick and Herrick, Certified Public Accountants, and the facts herein contained he believes to be true.

/s/ FRED H. BROWN,

EXHIBIT D

Computation of Overpayment by Petitioner of Excess Profits Tax—Year 1942

1.	Surtax Net Income on Completed Contract Basis—as adjusted		$ 912,061.67
	(a) Surtax Net Income on completed contract basis per Respondent's Determination—(Exhibit A Page 8)	922,502.21	
	(b) Less—additional amortization claimed by Petitioner per paragraph V(a)(2) of Petition	10,440.54	
2.	80% of Line 1		$ 729,649.34
3.	Normal and Surtax		None
4.	Excess Profits Tax Payable pursuant to Sec. 710 (a) (1) (B) of Internal Revenue Code—Prior to reduction for normal and surtax		729,649.34
5.	Excess Profits Tax Paid per Petitioner's Return for Year 1942		1,268,998.53
6.	Overpayment by Petitioner subject to refund if Petitioner is not subject to any normal or surtax		539,349.19
7.	Add—Normal and Surtax per determination made by Respondent		71,655.21
8.	Overpayment by Petitioner subject to refund if Petitioner's Normal and Surtax liability is in the amount shown on Line 7 hereof		611,004.40

[Endorsed]: T.C.U.S. Filed April 22, 1946.

[Title of Tax Court and Cause.]

REQUEST FOR PLACE OF HEARING

Petitioner hereby requests that the above entitled proceeding be placed upon the circuit calendar for hearing on the merits at San Francisco, California.

Petitioner's counsel are located in San Francisco, and a hearing in that city will result in the least inconvenience and expense to petitioner.

Dated San Francisco, California, April 18, 1946.

/s/ ANSON HERRICK,
/s/ L. W. WRIXON,
/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
Counsel for Petitioner.

[Endorsed]: T.C.U.S. Filed April 22, 1946.

[Endorsed]: T.C.U.S. Granted April 29, 1946. Signed Bolan B. Turner, Judge. [33]

[Title of Tax Court and Cause.]

ANSWER

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the petition filed by the above-named petitioner admits and denies as follows:

I. Admits the allegations contained in paragraph

I of the petition, except it is denied that completed returns were filed prior to May 14, 1943.

II and III. Admits the allegations contained in paragraphs II and III of the petition.

IV (a) to (f), inclusive. Denies that the Commissioner erred in the determining of the deficiency as alleged in paragraph IV of the petition and subparagraphs (a) to (f), inclusive, thereunder.

V (a) (1). Denies the allegations contained in subparagraph (a) (1) of paragraph V of the petition. [34]

V (a) (2). For lack of information, denies the allegations contained in subparagraph (a) (2) of paragraph V of the petition.

V (b) (1) and (2). Admits the allegations contained in subparagraphs (b) (1) and (2) of paragraph V of the petition.

V (b) (3). For lack of information, denies the allegations contained in subparagraph (b) (3) of paragraph V of the petition.

V (c) (1). Admits the allegations contained in subparagraph (c) (1) of paragraph V of the petition.

V (c) (2). Denies the allegations of fact contained in subparagraph (c) (2) of paragraph V of the petition.

V (d) (1). Admits the allegations contained in subparagraph (d) (1) of paragraph V of the petition.

V (d) (2). Denies the allegations of fact contained in subparagraph (d) (2) of paragraph V of the petition.

V (e). Denies the allegations contained in subparagraph (e) of paragraph V of the petition.

V (f). Admits the allegations contained in subparagraph (f) of paragraph V of the petition, except it is denied petitioner overpaid its excess profits tax or that payments were made as alleged.

VI. Denies generally and specifically each and every allegation in the petition not hereinbefore admitted, qualified or [35] denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel;

T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed June 4, 1946. [36]

[Title of Tax Court and Cause.]

MOTION FOR LEAVE TO FILE AMENDMENTS TO PETITION

Comes now the petitioner, Basalt Rock Co., Inc., by its attorneys of record, Anson Herrick, C.P.A., L. W. Wrixon, Esq., Sigvald Nielson, Esq., and Harry R. Horrow, Esq., and moves that leave be

given to file with this motion the amendments to the petition originally filed in this proceeding which are attached hereto. In support of this motion petitioner shows as follows:

1. Since the mailing of the notice of deficiency involved in this proceeding, the petitioner has paid the amount of 251,790.53, plus interest thereon in the amount of $50,854.79, by reason of the fact that it had withdrawn an application for relief under section 722 of the Internal Revenue Code for the year 1942. Said amount of $251,790.53 was deferred by petitioner on its excess profits tax return for 1942 under the provisions of [37] section 710 (a) (5) of the Internal Revenue Code pending consideration of said application for relief under section 722.

2. Amendment of the petition is necessary to set forth the petitioner's claim of an overpayment with respect to the aforesaid amount of $251,790.53, together with interest as provided by law.

Wherefore, it is prayed that this motion be granted.

Dated August 19, 1946.

/s/ ANSON HERRICK.
/s/ L. W. WRIXON,
/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
Counsel for Petitioner.

[Endorsed]: T.C.U.S. Filed Aug. 27, 1946.

[Endorsed]: T.C.U.S. Granted Aug. 30, 1946. Signed Bolon B. Turner, Judge. [38]

[Title of Tax Court and Cause.]

AMENDMENTS TO PETITION

The above-named petitioner hereby amends its petition heretofore filed in the above-named proceeding, as follows:

1. Paragraph III of the petition is hereby amended to read as follows:

"The tax in controversy is corporation excess profits tax for the calendar year 1942 and in the amount of $1,194,008.04. The Commissioner has determined a deficiency in excess profits tax for said year in the amount of $583,003.64, of which the petitioner has paid since the mailing of the notice of deficiency involved in this proceeding the amount of $251,790.53, together with interest thereon from March 15, 1943, to the date of payment, and the petitioner claims that there is an overpayment in excess profits tax for said year in the sum of $862,-794.93, together with interest as provided by law."

2. Subparagraph (f) of paragraph IV of the petition is hereby amended to read as follows: [39]

"The respondent erred in determining that there is a deficiency in excess profits tax due from the petitioner for the year 1942 in the sum of $583,-003.64 and in failing to determine that there is an overpayment by petitioner in excess profits tax for said year in the sum of $862,794.93."

3. Subparagraph (f) of paragraph V of the petition is hereby amended to read as follows:

"On or about the 16th day of April, 1945, petitioner filed form 843, claim for refund to petitioner of excess profits tax for 1942 in the sum of $530,-996.76. A copy of said claim for refund in the amount of $530,996.76 is attached hereto, marked 'Exhibit C', and by this reference is incorporated herein and made a part hereof. Since the mailing of the notice of deficiency involved in this proceeding, the petitioner paid, on or about July 27, 1946, the amount of $251,790.53 as excess profits tax for the year 1942, together with interest thereon from March 15, 1943, to July 27, 1946, in the sum of $50,854.79. Said amount of $251,790.63 of excess profits tax was claimed as a deferment on the petitioner's excess profits tax return for the year 1942 under the provisions of section 710 (a) (5) of the Internal Revenue Code pending consideration of an application for relief under section 722 of the Internal Revenue Code. Said application for relief has been withdrawn by the petitioner and for that reason the petitioner has paid said amount of excess profits tax so deferred, together with interest thereon. Petitioner alleges that it has overpaid its excess profits tax for the year 1942 in the amount of $791,139.72 or in the event its normal tax and surtax liability for said year is $71,655.21, said overpayment is the amount of $862,-794.93, together with interest as provided by law, including interest paid on said amount of $251,-790.53. A statement attached hereto, marked 'Ex-

hibit D', and by this reference incorporated herein and made a part hereof, sets forth in detail the factors used in computing said overpayment of $791,139.72, or, in the alternative, $862,794.93. Petitioner paid excess profits tax for the year 1942 in the following amounts and on the following dates:

$334,000.00 on March 13, 1943;
$300,499.26 on June 15, 1943;
$317,249.64 on September 15, 1943;
$317,249.64 on December 15, 1943; and
$251,790.53 together with interest thereon of
$ 50,854.79 on July 27, 1946." [40]

4. The prayer of the petition is hereby amended to read as follows:

"Wherefore, petitioner prays that this court may hear this proceeding and determine that there is no deficiency in excess profits tax due from this petitioner for the year 1942; that there is an overpayment in excess profits tax due to petitioner for said year in the sum of eight hundred sixty-two thousand seven hundred ninety-four and ninety-three hundredths dollars ($862,794.93), together with interest as provided by law, including interest on the sum of two hundred fifty-one thousand seven hundred ninety and fifty-three hundredths dollars ($251,790.53), and that the amount of said overpayment was paid within three (3) years from the date of the filing of the claim for refund thereof or from the date of filing this petition or subse-

quent to the date of mailing of the notice of deficiency, as the case may be; and for such other relief as may be proper."

Dated San Francisco, California, Aug. 19, 1946.

/s/ ANSON HERRICK,
/s/ L. W. WRIXON,
/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
Counsel for Petitioner. [41]

State of California,
County of Napa—ss.

A. G. Streblow, being first duly sworn, says that he is an officer, to wit, President, of Basalt Rock Co., Inc., the petitioner named in the foregoing and annexed amendments to petition, and that as such officer he is duly authorized to verify said amendments to petition; that he has read the foregoing amendments to petition and is familiar with the statements contained therein, and that the statements contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

A. G. STREBLOW,

Subscribed and sworn to before me this 19th day of August, 1946.

(Seal) JOHN R. ANDERSON,
Notary Public in and for the County of Napa, State of California.
My Commission Expires March 27, 1949.

[Endorsed]: Filed Aug. 30, 1946. [42]

[Title of Tax Court and Cause.]

ANSWER TO AMENDMENTS TO PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the amendments to petition filed by the above-named petitioner admits and denies as follows:

1. Admits that the tax in controversy is corporation excess profits tax for the calendar year 1942 and in the amount of $1,194,008.04. Admits that the Commissioner has determined a deficiency in excess profits tax for said year in the amount of $583,-003.64, but for lack of information denies the remaining allegations contained in paragraph 1 of the amendments to petition.

2. Denies the allegations contained in paragraph 2 of the amendments to petition. [43]

3. Admits that on or about the 16th day of April, 1945, petitioner filed form 843, claim for refund to petitioner of excess profits tax for 1942 in the sum of $530,996.76, but for lack of information denies the remaining allegations contained in paragraph 3 of the amendments to petition.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel;

T. M. MATHER,
Special Attorney,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Sept. 23, 1946. [44]

[Title of Tax Court and Cause.]

MOTION FOR LEAVE TO FILE SECOND AMENDMENTS TO PETITION

Comes now the petitioner, Basalt Rock Co., Inc., by its attorneys of record, Anson Herrick, C.P.A., L. W. Wrixon, Esq., Sigvald Nielson, Esq., and Harry R. Horrow, Esq., and moves that leave be given to file with this motion the amendments to the petition originally filed in this proceeding which are attached hereto. In support of this motion petitioner shows as follows:

1. Since the filing of the petition and the amendments to the petition in this proceeding, the revenue agent's report [45] on petitioner's income and excess profits tax return for the taxable year 1943

has disclosed that petitioner overstated its income for income and excess profits tax purposes for the year 1942 by reason of its erroneous accrual in said year of a certain claim which it had against the United States of America.

2. An amendment of the petition is necessary to set forth the petitioner's claim of an overpayment arising out of the correction of said erroneous accrual.

Wherefore, it is prayed that this motion be granted.

Dated December 6, 1946.

/s/ ANSON HERRICK,
/s/ L. W. WRIXON,
/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
Counsel for Petitioner.

[Endorsed]: T.C.U.S. Filed Dec. 13, 1946.

[Endorsed]: T.C.U.S. Granted Dec. 13, 1946. Signed Ernest H. Van Fossan, Judge. [46]

[Title of Tax Court and Cause.]

SECOND AMENDMENTS TO PETITION

The above-named petitioner hereby amends its petition heretofore filed in the above-named proceeding, as follows:

1. Paragraph III of the amended petition is hereby amended to read as follows:

"The tax in controversy is corporation excess profits tax for the calendar year 1942 and in the amount of $1,266,788.49. The Commissioner has determined a deficiency in excess profits tax for said year in the amount of $583,003.64, of which the petitioner has paid since the mailing of the notice of deficiency involved in this proceeding the amount of $251,790.53, together with interest thereon from March 15, 1943, to the date of payment, and the petitioner claims that there is an overpayment in excess profits tax for said year in the sum of $935,575.38, together with interest as provided by law."

2. Paragraph IV of the amended petition is hereby amended by inserting therein a new subparagraph as follows: [47]

"(a) (1). The respondent erred in failing to determine that petitioner in its income and declared value excess profits tax and excess profits tax returns for the year 1942 overstated its gross receipts from long-term contracts for said year in the amount of $86,000, on account of the erroneous accrual as income of a claim against the United States for reimbursement, and in failing to adjust petitioner's net income for income and excess profits tax purposes for the year 1942 by reason of said overstatement."

3. Subparagraph (f) of paragraph IV of the amended petition is hereby amended to read as follows:

"The respondent erred in determining that there is a deficiency in excess profits tax due from the

petitioner for the year 1942 in the sum of $583,-003.64 and in failing to determine that there is an overpayment by petitioner in excess profits tax for the said year in the sum of $935,575.38."

4. Paragraph V of the amended petition is hereby amended by inserting therein a new subparagraph as follows:

"(a) (3). In arriving at its income from long-term contracts for purposes of its income and declared value excess profits tax and excess profits tax returns for the year 1942, petitioner erroneously included as gross receipts on its contract No. 80586 the amount of $86,000, representing a claim against the United States of America for reimbursement thereunder for wage expenses. Petitioner was at no time entitled to or did receive said amount so claimed. No adjustment of petitioner's net income for income and excess profits tax purposes on account of such overstatement of income for the year 1942 was made by the Commissioner in arriving at the deficiencies involved in this proceeding."

5. Subparagraph (c) (2) of paragraph V of the amended petition is hereby amended to read as follows:

"(c) (2). Petitioner alleges that its excess profits tax for the year 1942 is limited under the provisions of section 710 (a) (1) (B) of the Internal Revenue Code to an amount which, when added to its normal tax and surtax for [48] the year 1942, equals 80 per cent of its surtax net income for said year determined under the provisions of section 15

of the Internal Revenue Code on a completed contract basis, as follows:

Surtax net income; $821,086.11

80 per cent thereof; $656,868.89

Less normal tax and surtax; $71,655.21

Excess profits tax under section 710 (a) (1) (B) $585,213.68."

6. Subparagraph (d) (2) of paragraph V of the amended petition is hereby amended to read as follows:

"(d) (2). Petitioner alleges that the income subject to excess profits tax for purposes of the credit under section 26 (e) of the Internal Revenue Code should be computed without regard to the 80 per cent limitation provision in section 710 (a) (1) (B) of the Internal Revenue Code and on the basis of the percentage of completion method. Said income subject to excess profits tax for the purposes of said credit was in excess of petitioner's normal tax and surtax net income, and there is no normal tax or surtax liability for the year 1942. Petitioner's excess profits tax for said year is limited to the amount of $656,868.89 or 80 per cent of its surtax net income computed under section 15 of the Internal Revenue Code on the completed contract basis."

7. Subparagraph (e) of paragraph V of the amended petition is hereby amended to read as follows:

"(e). In the alternative, in the event that the respondent correctly determined the credit allowable under section 26 (e) of the Internal Revenue

Code by using the completed contract method and that petitioner is liable to normal tax and surtax for 1942 in the total amount of $71,655.21, petitioner alleges that its excess profits tax liability for the year 1942 should be computed by subtracting said normal tax and surtax liability from the aforesaid sum of $656,868.89."

8. Subparagraph (f) of paragraph V of the amended petition is hereby amended to read as follows: [49]

"On or about the 16th day of April, 1945, petitioner filed form 843, claim for refund to petitioner of excess profits tax for 1942 in the sum of $530,996.76. A copy of said claim for refund in the amount of $530,996.76 is attached hereto, marked 'Exhibit C', and by this reference is incorporated herein and made a part hereof. Since the mailing of the notice of deficiency involved in this proceeding, the petitioner paid, on or about July 27, 1946, the amount of $251,790.53 as excess profits tax for the year 1942, together with interest thereon from March 15, 1943, to July 27, 1946, in the sum of $50,854.79. Said amount of $251,790.53 of excess profits tax was claimed as a deferment on the petitioner's excess profits tax return for the year 1942 under the provisions of section 710 (a) (5) of the Internal Revenue Code pending consideration of an application for relief under section 722 of the Internal Revenue Code. Said application for relief has been withdrawn by the petitioner and for that reason the petitioner has paid said

amount of excess profits tax so deferred, together with interest thereon. Petitioner alleges that it has overpaid its excess profits tax for the year 1942 in the amount of $863,920.17 or in the event its normal tax and surtax liability for said year is $71,655.21, said overpayment is the amount of $935,575.38, together with interest as provided by law, including interest paid on said amount of $251,790.53. A statement attached hereto, marked 'Exhibit D', and by this reference incorporated herein and made a part hereof, sets forth in detail the factors used in computing the amounts of overpayment claimed in the original petition. Petitioner paid excess profits tax for the year 1942 in the following amounts and on the following dates:

$334,000.00 on March 13, 1943;
$300,499.26 on June 15, 1943;
$317,249.64 on September 15, 1943;
$317,249.64 on December 15, 1943; and
$251,790.53 together with interest thereon of
$ 50,854.79 on July 27, 1946.

9. The prayer of the amended petition is hereby amended to read as follows: [50]

"Wherefore, petitioner prays that this court may hear this proceeding and determine that there is no deficiency in excess profits tax due from this petitioner for the year 1942; that there is an overpayment in excess profits tax due to petitioner for said year in the sum of nine hundred thirty-five thousand five hundred and seventy-five and thirty-eight

hundredths dollars ($935,575.38), together with interest as provided by law, including interest on the sum of two hundred fifty-one thousand seven hundred ninety and fifty-three hundredths dollars ($251,790.53), and that the amount of said overpayment was paid within three (3) years from the date of the filing of the claim for refund thereof or from the date of filing this petition or subsequent to the date of mailing of the notice of deficiency, as the case may be; and for such other relief as may be proper."

Dated San Francisco, California, Dec. 6, 1946.

/s/ ANSON HERRICK,

/s/ L. W. WRIXON,

/s/ SIGVALD NIELSON,

/s/ HARRY R. HORROW,

Counsel for Petitioner. [51]

State of California,
County of Napa—ss.

A. G. Streblow, being first duly sworn, says that he is an officer, to wit, President, of Basalt Rock Co., Inc., the petitioner named in the foregoing and annexed amendments to petition, and that as such officer he is duly authorized to verify said amendments to petition; that he has read the foregoing amendments to petition and is familiar with the statements contained therein, and that the state-

ments contained therein are true, except those stated to be upon information and belief, and that those he believes to be true.

A. G. STREBLOW.

Subscribed and sworn to before me this 6th day of December, 1946.

JOHN R. ANDERSON,
Notary Public in and for the County of Napa, State of California.

My Commission Expires March 27, 1960.

[Endorsed]: T.C.U.S. Filed Dec. 13, 1946. [52]

[Title of Tax Court and Cause.]

ANSWER TO SECOND AMENDMENTS TO PETITION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and for answer to the second amendments to petition filed by the above-named petitioner, admits and denies as follows:

1. Admits that the tax in controversy is excess profits tax for the calendar year 1942; admits that the Commissioner has determined a deficiency in excess profits tax said year in the amount of $583,-003.64; denies the remaining allegations contained in paragraph 1 of the second amendments to petition.

2 to 9, inclusive. Denies the allegations contained

in paragraphs 2 to 9, inclusive, of the second amendments to petition.

10. Denies generally and specifically every allegation in the second amendments to petition not hereinbefore admitted, qualified or denied.

Wherefore, it is prayed that the Commissioner's determination be approved and the petitioner's appeal denied.

/s/ J. P. WENCHEL,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel,

T. M. MATHER,
LEONARD RAUM,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Dec. 13, 1946. [53]

[Title of Tax Court and Cause.]

STIPULATION OF FACTS

It is hereby stipulated and agreed by and between the parties hereto, through their respective attorneys, that the following facts shall be taken to be true and received as evidence for the purposes of this proceeding only, subject to the right of either party to introduce any further evidence not inconsistent with or contrary to the facts herein stipulated:

1. Petitioner is a corporation duly incorporated and existing under the laws of the State of California, and engaged in the business of shipbuilding and manufacturing concrete aggregates, road and fuel oils, and building materials. The principal office of petitioner is located at 8th and River Streets in the City of Napa, County of Napa, State of California. The petitioner files its Federal income and excess profits tax returns on the calendar year basis. Its Federal corporation income and declared value excess profits tax return, Form 1120, and its Federal excess profits tax return, Form 1121, for the calendar year 1942 were each filed with the Collector of Internal Revenue for the First District of California on May 14, 1943. Petitioner was granted an extension of time to May 15, 1943 within which to file Forms 1120 and 1121 for the year 1942. [54]

2. During the year 1942, and prior and subsequent thereto, petitioner entered into certain con-

tracts, the performance of each of which required more than twelve months. Said contracts will hereinafter be termed "long-term contracts". The method of accounting regularly employed by petitioner in keeping its books of account and in filing its Federal corporation income and declared value excess profits tax returns (Form 1120) was the accrual method, except that with respect to said long-term contracts the method of accounting regularly employed by petitioner in keeping its books of account and in filing its Federal corporation income and declared value excess profits tax returns (Form 1120) was the completed contract method as permitted by section 29.42-4(b) of Regulations 111 and corresponding provisions of prior Regulations. Petitioner filed its Federal corporation income and declared value excess profits tax return (Form 1120) for the year 1942 in accordance with said methods of accounting.

3. Petitioner, at or prior to the time of filing its Federal excess profits tax return, Form 1121, for the year 1942, exercised the election provided in section 736(b) of the Internal Revenue Code.

4. Petitioner for the year 1942 realized income from certain long-term contracts and sustained losses from other long-term contracts, determined on the percentage of completion method of accounting, resulting in a net income for the year 1942 from all of [55] petitioner's long-term contracts, determined on said method of accounting of $409,-

538.97. Said amount of $409,538.97 is computed as follows:

	Income or (Loss)
Contract No. 80586	($558,669.46)
Contract No. 87525	(107,450.04)
Contract No. 34	269,646.53
Contract No. 2310	359,181.26
Contract No. 661	451,827.33
Contract No. 808	(4,996.65)
Petitioner's net income for 1942 from all of its long-term contracts, determined on the percentage of completion method of accounting	$409,538.97

Contract Nos. 80586 and 87525 were each completed by petitioner in the year 1942. Contract Nos. 34, 2310, 661, and 808, were each completed by petitioner in the year 1944.

5. The amounts specified in paragraph 4 as income or loss from long-term contracts include adjustments for accelerated amortization deductions to which petitioner is entitled for the year 1942, in addition to amounts claimed on its Federal tax returns and allowed by the respondent in the notice of deficiency, as follows:

Contract No. 80586	$ 6,986.08
Contract No. 87525	3,454.46
Contract No. 34	13,143.09
Contract No. 2310	8,940.32
Contract No. 661	3,366.53

The amount specified in paragraph 4 as the loss on contract No. 80586 includes adjustment for the overstatement of gross receipts from said contract in petitioner's Federal tax returns and in the respondent's notice of deficiency in the amount of $62,771.40.

6. Petitioner sustained losses for the year 1942 from long-term contracts, determined on the completed contract method of accounting, in the amount of $889,898.02. Said amount of $889,898.02 is computed as follows:

	(Loss)
Contract No. 80586	($765,448.63)
Contract No. 87525	(124,349.39)
Petitioner's losses for 1942 from all its long-term contracts, determined on the completed contract method of accounting	($889,898.02)

7. The amounts specified in paragraph 6 as losses from long-term contracts include adjustments for accelerated amortization deductions for the years 1941 and 1942 to which the petitioner is entitled for the year 1942 in addition to the amounts claimed on its Federal tax returns and allowed by respondent in the notice of deficiency, as follows:

Contract No. 80586	$ 11,520.81
Contract No. 87525	3,895.29

The amount specified in paragraph 6 as the loss on contract No. 80586 includes adjustment for the overstatement of gross receipts from said contract in petitioner's Federal tax returns and in the respondent's notice of deficiency in the amount of $86,000.00.

8(a). Petitioner's corporation surtax net income for the year 1942, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, exclusive of any income or loss from long-term contracts and computed without regard to the credit provided

in section 26(e) of the Internal Revenue Code, was $1,710,984.13. Said amount of $1,710,984.13, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, is to be adjusted to reflect the proper amount of income or loss for the year 1942 from long-term contracts.

8(b). If petitioner's corporation surtax net income for the year 1942, for purposes of section 710 (a)(1)(B) of the Internal Revenue Code, is to be determined by computing income or loss from long-term contracts on the percentage of completion method of accounting, said corporation surtax net income for such purposes, computed without regard to the credit provided in section 26(e) of the Internal Revenue Code, is $2,120,523.10. Said amount of $2,120,523.10 is computed as follows:

Net income, exclusive of any income or loss from long-term contracts	$ 1,710,984.13
Plus: Income from long-term contracts, determined on the percentage of completion method of accounting	409,538.97
Net income, determined by computing income from long-term contracts on the percentage of completion method of accounting	$ 2,120,523.10
Corporation surtax net income, determined by computing income from long-term contracts on the percentage of completion method of accounting and computed without regard to the credit provided in section 26(e) of the Internal Revenue Code	$ 2,120,523.10

8(c). If petitioner's corporation surtax net income for the year 1942, for purposes of section 710 (a)(1)(B) of the Internal Revenue Code, is to be determined by computing income or loss from long-

term contracts on the completed contract method of accounting, said corporation surtax net income for such purposes, computed without regard to the credit provided in section 26(e) of the Internal Revenue Code, is $821,086.11. Said amount of $821,086.11 is computed as follows:

Net income, exclusive of any income or loss from long-term contracts	$ 1,710,984.13
Less: Losses from long-term contracts determined on the completed contract method of accounting..	889,898.02
Net income, determined by computing income from long-term contracts on the completed contract method of accounting	$ 821,086.11
Corporation surtax net income, determined by computing income from long-term contracts on the completed contract method of accounting and computed without regard to the credit provided in section 26(e) of the Internal Revenue Code	$ 821,086.11

8(d). Subparagraph (b) of this paragraph is not to be construed as an admission by petitioner that its net income and its corporation surtax net income, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, is properly to be determined by computing income or loss from long-term contracts on the percentage of completion method of accounting. Subparagraph (c) of this paragraph is not to be construed as an admission by respondent that petitioner's net income and petitioner's corporation surtax net income, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, is properly to be determined by computing income or loss from long-term contracts on the completed contract method of accounting.

9. Petitioner's normal tax net income for the year 1942, for purposes of determining petitioner's normal tax for the year 1942 imposed by Chapter 1 of the Internal Revenue Code, and petitioner's corporation surtax net income for the year 1942, for purposes of determining petitioner's surtax for the year 1942 imposed by Chapter 1 of the Internal Revenue Code, each computed without regard to the credit provided in Section 26(e) of the Internal Revenue Code, were each $821,086.11. Said amount of $821,086.11 is computed as follows: [60]

Net income, exclusive of any income or loss from long-term contracts		$ 1,710,984.13
Less: Losses from long-term contracts, determined on the completed contract method of accounting		889,898.02
Net income, determined by computing income from long-term contracts on the completed contract method of accounting	$	821,086.11
Normal-tax net income, for purposes of the normal tax imposed by Chapter I of the Internal Revenue Code, computed without regard to the credit provided in section 26(e) of the Internal Revenue Code	$	821,086.11
Corporation surtax net income, for purposes of the surtax imposed by Chapter I of the Internal Revenue Code, computed without regard to the credit provided in section 26(e) of the Internal Revenue Code	$	821,086.11

Nothing in this paragraph shall be construed as stipulating, either directly or indirectly or by inference, either the method of determining or the amount of petitioner's corporation surtax net income for the year 1942 for purposes of section 710 (a)(1)(B) of the Internal Revenue Code.

10. Petitioner's adjusted excess profits net in-

come for the year 1942, determined by computing income or loss from long-term contracts on the percentage of completion method of accounting, was $1,845,468.76. Said amount of $1,845,468.76 is computed as follows: [61]

Normal-tax net income, exclusive of any income or loss from long-term contracts and computed without regard to the credit provided in section 26(e) of the Internal Revenue Code		$ 1,710,984.13
Plus: Net income from long-term contracts, determined on the percentage of completion method of accounting		409,538.97
Normal-tax net income, determined by computing income from long-term contracts on the percentage of completion method of accounting, and computed without regard to the credit provided in section 26(e) of the Internal Revenue Code		$ 2,120,523.10
Less:		
Net gain from sale or exchange of capital assets held for more than six months	$ 37,617.15	
Nontaxable income from exempt excess output under section 735 of the Internal Revenue Code	81,809.89	
		$ 119,427.04
Excess profits net income, determined by computing income from long-term contracts on the percentage of completion method of accounting		$ 2,001,096.06
Less:		
Specific exemption	$ 5,000.00	
Excess profits credit (income method)	150,627.30	
Unused excess profits credit adjustment	None	
		$ 155,627.30
Adjusted excess profits net income, determined by computing income from long-term contracts on the percentage of completion method of accounting		$ 1,845,468.76

11. Petitioner does not admit that it has an adjusted excess profits net income for the year 1942 which is determined by computing income or loss from long-term contracts on the completed contract method of accounting. Petitioner agrees, however, and it is so stipulated, that if petitioner does have an adjusted excess profits net income which is determined by computing income or loss from long-term contracts on the completed contract method of accounting, said adjusted excess profits net income so determined is $546,031.77. Said amount of $546,031.77 is computed as follows:

Normal-tax net income, exclusive of any income or loss from long-term contracts and computed without regard to the credit provided in section 26(e) of the Internal Revenue Code		$ 1,710,984.13
Less: Losses from long-term contracts, determined on the completed contract method of accounting		889,898.02
Normal-tax net income, determined by computing income from long-term contracts on the completed contract method of accounting, and computed without regard to the credit provided in section 26(e) of the Internal Revenue Code		$ 821,086.11
Less:		
Net gain from sale or exchange of capital assets held for more than six months	$ 37,617.15	
Nontaxable income from exempt excess output under section 735 of the Internal Revenue Code	81,809.89	
		$ 119,427.04
Excess profits net income, determined by computing income from long-term contracts on the completed contract method of accounting		$ 701,659.07

Less:		
Specific exemption	$ 5,000.00	
Excess profits credit (income method)	150,627.30	
Unused excess profits credit adjustment	None	
		$ 155,627.30
Adjusted excess profits net income, determined by computing income from long-term contracts on the completed contract method of accounting		$ 546,031.77

12. There was no increase, attributable to contracts completed in 1942, in petitioner's excess profits tax imposed for either 1940 or 1941 due to its exercise of the election provided in section 736(b) of the Internal Revenue Code.

13. Petitioner paid excess profits tax for the year 1942 in the following amounts and on the following dates:

$333,042.61 on March 15, 1943,
$301,456.65 on June 15, 1943,
$317,249.64 on September 15, 1943,
$317,249.63 on December 15, 1943, and
$251,790.53, together with interest thereon of $ 50,854.79, on July 30, 1946.

Petitioner in its excess profits tax return for 1942 claimed the right to defer the payment of $251,790.53 under the provisions of section 710(a)(5) of the Internal Revenue Code pending consideration of a claim under section 722 of the Internal Revenue Code for [64] the year 1942. The payment of said $251,790.53 was so deferred. Said claim under section 722 of the Internal Revenue Code for the year 1942 was withdrawn prior to the

date of mailing of the notice of deficiency herein. Petitioner paid the said $251,790.53, payment of which had been deferred under the provisions of section 710(a)(5) of the Internal Revenue Code, together with interest thereon of $50,854.79, on July 30, 1946.

14. On or about March 15, 1946, petitioned filed an application under the provisions of section 124 (j) of the Internal Revenue Code for tentative adjustment of its excess profits tax for the year 1942 due to revised amortization deduction. Subsequent to the filing of said application and to the filing of the petition herein, said application was allowed by respondent with respect to petitioner's excess profits tax for the year 1942 in the amount of $32,301.43 and the petitioner was allowed credit or refund of $29,071.29 of its excess profits tax for the year 1942 (said sum of $29,071.29 being said $32,301.43 minus the post-war refund credit of $3,230.14 under section 780 of the Internal Revenue Code attributable to said $32,301.43), plus $3,302.05 interest, based on said application.

15. Petitioner in its excess profits tax return for 1942 showed an excess profits tax of $1,520,-789.06. As stated in paragraph 13, supra. petitioner claimed the right to defer payment [65] of $251,790.53 under the provisions of section 710(a)(5) of the Internal Revenue Code, and payment of said $251,790.53 was so deferred. Petitioner in said excess profits tax return for 1942 accordingly showed an excess profits tax payable of $1,268,-998.53. Petitioner received post-war refund bonds,

with respect to the year 1942, issued under the provisions of section 780 of the Internal Revenue Code, in the amount of $126,899.85. All of said bonds in the amount of $126,899.85 were cashed by petitioner on January 8, 1946.

/s/ SIGVALD NIELSON,

/s/ HARRY R. HORROW,
Counsel for Petitioner.

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Of Counsel:

B. H. NEBLETT,
Division Counsel.

T. M. MATHER,
LEONARD RAUM,
Special Attorneys,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Dec. 13, 1946. [66]

[Title of Tax Court and Cause.]

ORDER OF CONTINUANCE

This proceeding was called from the calendar of December 13, 1946 at San Francisco, California, and heard in part, on motion of counsel for the parties to continue to the Washington, D. C., calendar for further hearing, and requesting that the proceeding be not set for a period of 60 days, it is

Ordered: That the motion is granted, and the proceeding is continued to the Washington, D. C., calendar of February 12, 1947.

(Seal) /s/ ERNEST H. VAN FOSSAN,
Judge.

Dated December 13, 1946. San Francisco, Calif.

[67]

[Title of Tax Court and Cause.]

SUPPLEMENTAL STIPULATION OF FACTS

This supplemental stipulation of facts, except for paragraphs 10 and 11, is entered into at the request of counsel for petitioner. It is stipulated between the parties hereto, by their respective counsel, that the following facts are true and may be received in evidence by The Tax Court in this proceeding, subject only to the respondent's exception to the materiality or relevancy of the facts stated in paragraphs 1 through 9, inclusive, to the decision of the issues presented in this proceeding:

1. Under date of March 27, 1946, the Bureau of Internal Revenue reported a case to the Chairman of the Joint Committee on Internal Revenue Taxation, Congress of the United States, as required by section 3777(a) of the Internal Revenue Code, involving proposed over-assessments of income and excess profits taxes of over $75,000. The proposed over-assessments of excess profits tax were for the most part based on the application of section 35.736 (a)-3 of Regulations 112 [68] which in effect provides that, in the case of a taxpayer which computes its income from installment sales under the method provided by section 44(a) of the Internal Revenue Code for purposes of the income tax imposed by chapter 1 of the Code and which has exercised the election provided in section 736(a) of the Code to compute its income from installment sales on the accrual method of accounting for purposes of the excess profits tax imposed by chapter 2E of the Code, corporation surtax net income shall be determined, for purposes of section 710(a) (1)(B) of the Code, by computing income from installment sales on the accrual method of accounting. The excess profits tax liability of the taxpayer in the said case was computed under section 710 (a)(1)(B) of the Code and section 35.736(a)-3 of Regulations 112 in determining the amount of said proposed overassessments. Under date of April 11, 1946, the Treasury Department was informed by the Chief of Staff of the Joint Committee that a report to him by members of his staff disclosed no basis for unfavorable criticism of the overassess-

ments and that the Bureau of Internal Revenue should proceed with the disposition of the case in whatever manner it saw fit. The proposed overassessments were accordingly allowed and abatements, credits, and refunds in the amount of said overassessments were allowed and made.

2. Under date of May 23, 1946, the Bureau of Internal Revenue reported to the Chairman of the Joint Committee on Internal Revenue [69] Taxation a second case involving proposed overassessments of income tax and excess profits tax of over $75,000. The proposed overassessments of excess profits tax in this case, as in the case referred to in paragraph 1, supra, were due in part to the application of the provisions of section 35.736(a)-3 of Regulations 112 relating to the determination of corporation surtax net income for purposes of section 710(a)(1)(B) of the Internal Revenue Code. The excess profits tax liability of the taxpayer in the said case, as in the case referred to in paragraph 1, supra, was computed under section 710 (a)(1)(B) of the Code and section 35.736(a)-3 of Regulations 112 in determining the amount of the proposed overassessments.

Under date of June 27, 1946, the Chief of Staff of the Joint Committee transmitted to the Treasury Department a memorandum, prepared by one of the members of his staff and approved by the Assistant Chief of Staff of the Joint Committee, without any indication that the Chief of Staff of the Joint Committee approved the said memorandum but with the statement in the letter of trans-

mittal that if upon reading the said memorandum the Treasury Department was still of the opinion that the proposed refund should be made he would be glad to discuss the matter at a conference to be arranged. In said letter of transmittal the Chief of Staff of the Joint Committee did not advise the Treasury Department that it should proceed with the disposition of the case in whatever manner it saw fit. The memorandum states that "It is suggested that this case be objected to [70] for the reason that under the present section 35.736(a)-3 of Regulations 112 as amended by T.D. 5388, application of the 80 percent limitation allows taxpayer an excessive refund for 1942." The memorandum contains the following sentence: "It is submitted that section 35.736(a)-3 of Regulations 112 as amended by T.D. 5388 should be amended to conform to the opinion of Judge Kern in the West End Furniture Co. case, supra, so that the 80 percent limitation under section 710(a)(1)(B) of the Code as amended shall apply to surtax net income computed on the installment basis, in those cases involving taxpayers returning income on the installment sales basis under section 44(a) of the Code and electing under section 736(a) of the Code as amended to compute excess profits tax liability on the accrual basis." Under date of December 16, 1946, the Chief Counsel for the Bureau of Internal Revenue informed the Chief of Staff of the Joint Committee by letter that he was "still of the opinion that the overassessment [in the case referred to in this paragraph] should be approved."

No further action has been taken either by the Bureau of Internal Revenue or by the Staff of the Joint Committee with respect to the said case since the Chief Counsel for the Bureau of Internal Revenue sent the said letter of December 16, 1946 to the Chief of Staff of the Joint Committee. The proposed overassessments in the said case have been neither [71] allowed nor disallowed as of the date this supplemental stipulation of facts was entered into by the parties to this proceeding.

3. Under date of August 23, 1946, the Bureau of Internal Revenue reported to the Chairman of the Joint Committee on Internal Revenue Taxation a third case involving proposed overassessments of income tax, declared value excess profits tax, and excess profits tax of over $75,000. The proposed overassessments of excess profits tax in this case, as in each of the cases referred to in paragraphs 1 and 2, supra, were due in part to the application of the provisions of section 35.736(a)-3 of Regulations 112 relating to the determination of corporation surtax net income for purposes of section 710 (a)(1)(B) of the Internal Revenue Code. The excess profits tax liability of the taxpayer in the said case, as in each of the cases referred to in paragraphs 1 and 2, supra, was computed under section 710(a)(1)(B) of the Code and section 35.736(a)-3 of Regulations 112 in determining the amount of the proposed overassessments.

Under date of September 19, 1946, the Chief of Staff of the Joint Committee transmitted to the

Treasury Department a memorandum, prepared by the Assistant Chief of Staff of the Joint Committee, without any indication that the Chief of Staff of the Joint Committee approved the said memorandum but with the statement in the letter of transmittal that if upon reading the said memorandum the Treasury Department [72] was still of the opinion that the proposed refund should be made he would be glad to discuss the matter at a conference to be arranged. In said letter of transmittal the Chief of Staff of the Joint Committee did not advise the Treasury Department that it should proceed with the disposition of the case in whatever manner it saw fit. The memorandum states that in the opinion of the author the proposed refund should not be agreed to and that whatever disposition is made of the case referred to in paragraph 2, supra, would obviously govern with respect to the said case. The memorandum points out that the objection therein raised was predicated not solely on the original opinion promulgated in the West End Furniture Company case, 6 T.C. 557, but on the belief that the conclusion reached represented the correct interpretation of the statute. Under date of December 16, 1946, the Chief Counsel for the Bureau of Internal Revenue informed the Chief of Staff of the Joint Committee by letter that he was "still of the opinion that the overassessment [in the case referred to in this paragraph] should be approved." No further action has been taken either by the Bureau of Internal Revenue or by the Staff of the Joint Committee with respect to the

said case since the Chief Counsel for the Bureau of Internal Revenue sent the said letter of December 16, 1946 to the Chief of Staff of the Joint Committee. The proposed [73] overassessments in the said case have been neither allowed nor disallowed as of the date this supplemental stipulation of facts was entered into by the parties to this proceeding.

4. Under date of September 10, 1946, the Bureau of Internal Revenue reported to the Chairman of the Joint Committee on Internal Revenue Taxation a fourth case involving proposed overassessments of income tax, declared value excess profits tax, and excess profits tax of over $75,000. The proposed overassessments of excess profits tax in this case, as in each of the cases referred to in paragraphs 1, 2, and 3, supra, were due in part to the application of the provisions of section 35.736 (a)-3 of Regulations 112 relating to the determination of corporation surtax net income for purposes of section 710(a)(1)(B) of the Internal Revenue Code. The excess profits tax liability of the taxpayer in the said case, as in each of the cases referred to in paragraphs 1, 2, and 3, supra, was computed under section 710(a)(1)(B) of the Code and section 35.736(a)-3 of Regulations 112 in determining the amount of the proposed overassessments.

Under date of October 9, 1946, the Chief of Staff of the Joint Committee transmitted to the Treasury Department a memorandum, prepared by the As-

sistant Chief of Staff of the Joint Committee, without any indication that the Chief of Staff of the Joint Committee [74] approved the said memorandum but with the statement in the letter of transmittal that if upon reading the said memorandum the Treasury Department was still of the opinion that the proposed refund should be made he would be glad to discuss the matter at a conference to be arranged. In said letter of transmittal the Chief of Staff of the Joint Committee did not advise the Treasury Department that it should proceed with the disposition of the case in whatever manner it saw fit. The memorandum contains the following two sentences: "There is no question but that the taxpayer is entitled to the benefit of section 736(a) of the Code. The only doubt with respect to the computation of its excess profits tax relates to the method of computing the 80 percent limitation." The memorandum, after quoting extensively from the memorandum referred to in paragraph 3, supra, which was written by the same author as the memorandum written in connection with the case referred to in this paragraph, concludes by saying that it appears that the case referred to in this paragraph should be consolidated with the cases referred to in paragraphs 2 and 3, supra, and that "the overassessments proposed by the Commissioner should not be accepted by the Staff." Under date of December 16, 1946, the Chief Counsel for the Bureau of Internal Revenue informed the Chief of Staff of the Joint Committee by letter that he was "still of the opinion that the over-

assessment [in the case referred to in this paragraph] should be approved." No further action has been taken either by the Bureau of Internal Revenue or by the Staff of the Joint Committee with respect to the said case since the Chief Counsel for the Bureau of Internal Revenue sent the said letter of December 16, 1946 to the Chief of Staff of the Joint Committee. The proposed overassessments in the said case have been neither allowed nor disallowed as of the date this supplemental stipulation of facts was entered into by the parties to this proceeding.

5. The letters of December 16, 1946 from the Chief Counsel for the Bureau of Internal Revenue to the Chief of Staff of the Joint Committee referred to in paragraphs 2, 3 and 4, supra, are the same letter. That is, the Chief Counsel for the Bureau of Internal Revenue sent one letter to the Chief of Staff of the Joint Committee under date of December 16, 1946 in which he stated that he was still of the opinion that the proposed overassessments in each of the cases referred to in paragraphs 2, 3, and 4, supra, should be approved.

6. No case involving a proposed overassessment of excess profits tax in which the excess profits tax liability of the taxpayer was computed under section 710(a)(1)(B) of the Internal Revenue Code and the provisions of section 35.736(b)-3 of Regulations 112, or [76] the corresponding provisions of Regulations 109, which provisions of the regulations relate to the determination of corporation

surtax net income for purposes of section 710(a)(1)(B) of the Code in the case of a taxpayer which has exercised the election provided in section 736(b) of the Code to compute its income from long-term contracts on the percentage of completion method of accounting for purposes of the excess profits tax imposed by chapter 2-E of the Code, has been reported to or considered by the Joint Committee on Internal Revenue Taxation itself or the Staff of the Joint Committee.

7. No case involving a proposed overassessment of excess profits tax in which the excess profits tax liability of the taxpayer was computed under section 710(a)(1)(B) of the Internal Revenue Code and the provisions of section 35.736(a)-3 of Regulations 112, or the corresponding provisions of Regulations 109, which provisions of the regulations relate to the determination of corporation surtax net income for purposes of section 710(a)(1)(B) of the Code in the case of a taxpayer which has exercised the election provided in section 736(a) of the Code to compute its income from installment sales on the accrual method of accounting for purposes of the excess profits tax imposed by chapter 2E of the Code, has been considered by the Joint Committee on Internal Revenue Taxation itself as distinguished from the Staff of the Joint Committee. [77]

8. If the Treasury Department and the Staff of the Joint Committee are unable to come to an agreement on a proposed overassessment, the mat-

ter may be referred to the Joint Committee on Internal Revenue Taxation itself as distinguished from the Staff of the Joint Committee. Even though the Treasury Department and the Staff of the Joint Committee are in agreement on a proposed overassessment, said proposed overassessment may be referred to the Joint Committee itself. It is the practice of the Treasury Department not to allow a proposed overassessment in any case in which the Joint Committee on Internal Revenue Taxation has unfavorably criticised the proposed overassessment.

9. Respondent hereby waives all ojections, except those of materiality or relevancy to the decision of the issues presented in this proceeding, to the receipt in evidence of the letter marked for identification at the hearing in this proceeding as Petitioner's Exhibit 6.

10. Attached hereto is a copy of a memorandum from Deputy Commissioner of Internal Revenue E. I. McLarney, Head of the Income Tax Unit of the Bureau of Internal Revenue, to the Chief Counsel for the Bureau of Internal Revenue. Petitioner has no objection to the receipt of the original or a copy of said memorandum in evidence as a Respondent's Exhibit. [78]

11 (a). Petitioner's credit for income subject to the excess profits tax, provided in section 26(e) of the Internal Revenue Code, which is allowable for the year 1942 is $546,031.77. Said amount of $546,-

031.77 is computed as shown in subparagraphs (b) and (c) of this paragraph.

(b). Petitioner's excess profits tax for the year 1942 computed pursuant to its election under section 736(b) of the Internal Revenue Code and without regard to the provisions of section 710(a)(1)(B) of the Code exceeds petitioner's excess profits tax for said year computed without regard to said election and without regard to said provisions of section 710(a)(1)(B) of the Code by the amount of $1,169,493.29. Said amount of $1,169,493.29 is computed as follows:

Adjusted excess profits net income, pursuant to election under section 736 (b) of the Code	$ 1,845,468.76	
Excess profits tax under section 710(a)(1)(A) of the Code, pursuant to election under section 736 (b) of the Code (90% of $1,845,468.76)		$ 1,660,921.88
Adjusted excess profits net income, without regard to election under section 736 (b) of the Code	546,031.77	
Excess profits tax under section 710 (a)(1)(A) of the Code, without regard to election under section 736 (b) of the Code, (90% of $546,031.77)		$ 491,428.59
Increase in excess profits tax imposed for the year 1942, due to election under section 736 (b) of the Code, which is considered to be part of the excess profits tax for a subsequent taxable year for purposes of the credit provided in section 26 (e) of the Code		$ 1,169,493.29

(c). Petitioner's credit for income subject to the excess profits tax, provided in section 26(e) of the Internal Revenue Code, which is allowable for the year 1942 is $546,031.77. Said amount of $546,-031.77 is computed as follows:

Excess profits tax imposed by section 710(a)(1)(A) of the Internal Revenue Code for the year 1942 computed upon the completed contract basis method of accounting		$491,428.59
Plus:		
Excess profits tax imposed for 1940, attributable to contracts completed in 1942, due to petitioner's exercise of the election provided in section 736 (b) of the Internal Revenue Code	0	
Excess profits tax imposed for 1941, attributable to contracts completed in 1942, due to petitioner's exercise of the election provided in section 736 (b) of the Internal Revenue Code	0	0
Tax imposed by subchapter E of chapter 2 of the Internal Revenue Code for the year 1942 for purposes of section 26 (e) of the Internal Revenue Code		$491,428.59
Credit provided under section 26 (e) of the Internal Revenue Code for income subject to the excess profits tax (10/9ths of $491,428.59)		$546,031.77

(d). Petitioner hereby waives its assignments of error contained in subparagraph (d) of paragraph IV of the petition, as amended, with respect to the determination of the credit for income subject to the [80] excess profits tax provided in section 26(e) of the Internal Revenue Code. Petitioner and respondent respectfully request the Court to take into account the above stipulated figure of $546,031.77 as petitioner's credit for in-

come subject to the excess profits tax provided in section 26(e) of the Internal Revenue Code in entering its decision in this proceeding.

/s/ SIGVALD NIELSON,
Counsel for Petitioner.
/s/ HARRY R. HARROW,
Counsel for Petitioner.

/s/ J. P. WENCHEL,
Chief Counsel, Bureau of Internal Revenue, Counsel for Respondent.

Of Counsel:
B. H. NEBLETT,
Division Counsel.

T. M. MATHER,
LEONARD RAUM,
Special Attorneys,
Bureau of Internal Revenue. [81]

Bureau of Internal Revenue
Income Tax Unit

January 20, 1947

Memorandum for Mr. J. P. Wenchel
Chief Counsel
Bureau of Internal Revenue

In re: Sections 35.736(a)-3 and 35.736(b)-3 of Regulations 112 and corresponding provisions of Regulations 109

Reference is made to your memorandum dated January 14, 1947, in which you request advice as

to whether it has been the purpose of this office to follow the provisions of the regulations at all times since their promulgation and whether to our knowledge there has ever been, or is now, any deviation from such purpose of disposing of cases in accord with the provisions of the regulations.

I have consulted with the Heads of the Audit Review Divisions and the Head of the Practice and Procedure Division, and they have informed me that they have never suggested or recommended that the regulations be deviated from and that to their knowledge there has never been any deviation from existing regulations in any case. This is also the observation of the Assistant Deputy Commissioner and the undersigned.

/s/ E. I. McLARNEY,
Deputy Commissioner.

[Endorsed]: T.C.U.S. Filed Feb. 12, 1947. [82]

The Tax Court of the United States

Docket No. 10620

BASALT ROCK CO., INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Room 417, Appraisers Building
630 Sansome Street
San Francisco, California

December 13, 1946—2:40 p.m.

(Met pursuant to notice.)

Before: Honorable Ernest H. Van Fossan, Judge.

Appearances: Harry R. Horrow, Esq., 225 Bush Street, San Francisco, California, appearing for the Petitioner. Leonard Raum, Esq. (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing for the Respondent. [85]

PROCEEDINGS

The Clerk: Docket No. 10620, Basalt Rock Company, Inc.

State your appearances.

Mr. Horrow: Ready for the Petitioner. Harry R. Horrow appears for the Petitioner.

Mr. Raum: Leonard Raum for the Respondent.

The Clerk: Of the Standard Oil Building, Mr. Horrow?

Mr. Horrow: Yes, care of Pillsbury, Madison

and Sutro, 225 Bush Street, San Francisco, California.

The Court: Would you state the issue in this matter, Mr. Horrow?

Mr. Horrow: If your Honor please, we have some amended pleadings to file in this matter. If I may, at this time I will file a Motion for Leave to File a Second Amendment to the Petition, together with the amendments thereto.

The Court: Is it an amended petition or amendment to the petition?

Mr. Horrow: Amendment to the petition.

The Court: Is there any objection?

Mr. Raum: No objection.

The Court: They may be filed.

Mr. Raum: I may at the same time file the Respondent's Answer to the Amended Petition.

The Court: It may be filed.

OPENING STATEMENT ON BEHALF OF THE PETITIONER

By Mr. Horrow: [86]

Mr. Horrow: If your Honor please, this case is an excess profits tax case for the year 1942. Commissioner has determined a deficiency in the amount of $583,003.64. The Petitioner is claiming an overpayment in the sum of $935,575.38. There are certain assignments of error in the petition and the amendments thereto that have been eliminated by stipulation. There remain two issues of law for your Honor's determination:

One issue relates to the application of the 80 per

cent limitation under Section 710 (a) (1) B of the Internal Revenue Code.

The other issue relates to the proper determination of the credit under Section 26 (e) of the Code.

The principal issue is the first point, namely, the application of limitation under Section 710 (a) (1) B. Section 710 (a) (1) B in brief provides that the excess profits tax shall be the lesser of two amounts: One amount computed by taking 90 percent of the adjusted excess profits net income; the other amount is to be determined by subtracting from it a sum equal to 80 percentum of the corporation surtax as income, computed under Section 15 without regard to this credit under Section 26 (e), the amount of the normal and surtax under Chapter 1, the Income Tax Provision of the Code.

The issue is as to the proper determination of the surtax, the corporation surtax net income computed under [87] Section 15 for the purposes of the Section to which I have referred. The controversy stems from an election which was exercised by the taxpayer under Section 736 (b) of the Code. The taxpayer was engaged in the performance of long-term contracts; that is, contracts which required performance over a period of more than 12 months. Its regular method of accounting in keeping its books and in filing its returns with respect to such long term contracts was the completed contract method and that method was used in computing its normal tax and surtax.

Under Section 736 it was afforded and it exercised an election to use the percentage of comple-

tion method. In arriving at the deficiency, the Respondent determined that the corporation surtax net income on which the 80 per cent limitation is based must be computed not by using the completed contract method, but by using the percentage of completion method.

There is no dispute that in arriving at the tax which is covered by the limitation under 710 (a) (1) B that the actual normal tax and surtax must be used.

Respondent has used that as a factor in arriving at the amount covered by the limitation under Section 710 (a) (1) B. The Respondent, however, has not used the actual surtax net income on which that surtax liability is based. Rather, the Respondent has constructed a surtax net income [88] by means of the percentage of completion method of accounting.

The Petitioner contends that not only must the actual normal tax and surtax be used in arriving at a proper amount under Section 710 (a) (1) B, but the actual surtax net income on which the surtax liability is based.

Now, this point is not entirely novel, your Honor, because it was considered by the Tax Court in the case of West End Furniture Company, promulgated on March 2, 1946, 6 Tax Court Number 71. In that opinion, Judge Kern stated that the surtax net income which is the basis for Section 710 (a) (1) B, is the surtax net income actually used in the computation of the surtax liability under Chapter 1.

After that opinion was handed down, the Respondent filed a motion asking that that portion of the opinion dealing with the 80 percent limitation be deleted. There were several grounds stated in that motion, one of which was that the Chief of Staff of the Joint Committee on Internal Revenue Taxation in reliance on the opinion in this case had withheld his approval of certain refunds in excess of $75,000, based on the present regulations which are at variance with the rule that the Court stated in the West End Furniture case.

There was no objection offered to the motion filed by the Commissioner for deletion of a portion of the opinion, and the Court accordingly granted the motion.

Despite the fact that the portion of the opinion [89] referred to was deleted, the Chief of Staff of the Joint Committee adheres to the same view, that the surtax net income to be used is the actual surtax net income on which the actual surtax must be determined and is imposed.

The Court: I take it that you wish to delete it because it was not in issue in this case according to your concept, but that it is in issue here?

Mr. Horrow: It is directly in issue here. One of the grounds alleged in the motion, your Honor, was that the Court's opinion with reference to the 80 per cent limitation was dictum. To what extent that influenced Judge Kern in granting the motion, I am not in a position to state, but the fact is that no objection was offered to the motion and the motion was granted.

Now, as I stated, the case involves only excess profits tax. Nevertheless, in order to arrive at the excess profits tax, it is necessary to determine the correct tax liability under Chapter 1 because that is a factor to be used in applying the provisions of Section 710 (a) (1) B. The controversy as to the Chapter 1 Tax involves the credit under Section 26 (e). Section 26 (e) provides a credit for both the normal tax and the surtax which generally speaking is the adjusted excess profits net income.

There are special provisions relating to the determination of the credit in the case of the taxpayer exercising [90] the election under Section 736 (b) as the taxpayer has done in this case. But, the Respondent in the Deficiency Notice has again constructed a net income and in this case the Respondent constructed an adjusted excess profits net income and used that as the factor in arriving at the 26 (e) credit.

I say that the Respondent constructed the adjusted excess profits net income because the Respondent used the completed contract method in arriving at that adjusted profits net income although the percentage of completion method was elected and was used by the Respondent in arriving at the adjusted excess profits net income for purposes of Section 710 (a) (1) A, on which the 90 percent tax is based.

The Petitioner contends that the measure of its credit under sections 26 (e) is the adjusted excess profits net income determined under the percentage of completion method and that there is only one

adjusted excess profits net income and that is determined under that method.

It is similar to the contention we make on the surtax net income, that there is only one surtax net income determined on the completed contract method, the surtax net income that is used in arriving at the surtax is the same as the surtax net income to be used in applying Section 710 (a) (1) B.

That states our case, your Honor.

The Court: Mr. Raum, do you wish to state your position? [91]

OPENING STATEMENT ON BEHALF OF THE RESPONDENT

By Mr. Raum:

Mr. Raum: If the Court please, as counsel for Petitioner has stated, there were several issues raised in the pleadings in this case which have been eliminated and as to which agreement has been reached by the parties, and we ask the Court to give effect to such agreement in the decision entered by the Court.

I should like, if your Honor please, to use this opening statement not to attempt to limit any of the issues properly raised in the pleadings or by any of the legal theories which may be used to support such issues, but to set before the Court what Respondent believes the issues are and its position on such issues.

Under the provisions of Regulation 111, and according to prior regulations on the income tax, a

taxpayer may elect, or rather may report its income from long term contracts; that is, contracts which take more than 12 months to perform, on any one of several different accounting methods.

One of such methods is the completed contract method of accounting. Under this method the income is reported in the final year in which the contract is completed. The petitioner regularly has kept his books of accounts and filed his income tax returns, that is its returns under Chapter 1 of the Internal Revenue Code, on such completed contract [92] method, and a taxpayer may not elect to change from such method to another method without permission by the Commissioner. However, under the provisions of Section 736 (b) of the Internal Revenue Code as enacted by Congress in the Revenue Act of 1942, a Taxpayer may elect to report its income from long term contracts on the percentage of completion method of accounting for purposes of excess profits tax. That is, a taxpayer like the petitioner in this case who is reporting his income from long term contracts on the completed contract method of accounting for purposes of the income tax imposed by Chapter 1, may elect to report its income on the percentage of completion method of accounting; that is, his income from those same contracts for the purpose of the excess profits tax and we thus have a case of the income from the same contracts being reported for two inter-locking taxes on two different and one might say inconsistent methods of accounting.

I say the taxes are inter-locking because the

amount of excess profits tax or the amount of income subject to the excess profits tax is a factor in determining the income tax, and therefore we have the situation of two inter-locking taxes, the income from the same contracts being reported for the purposes of these two inter-locking taxes on two different accounting methods.

Now, under the provision of Section 710 of the Internal Revenue Code, the excess profits tax is imposed as one [93] of two amounts: That is, it is the lesser of the two following amounts: It is either 90 per cent of the adjusted excess profits net income or it is such an amount which, when added to the tax imposed by Chapter 1, that is, to the income tax, equals 80 per cent of corporation surtax net income computed without regard to the credit for income subject to the excess profits tax, and without other credits not here material.

If I may, from here on, I shall refer to the corporation surtax net income, as it is provided in Section 710 (a).

The excess profits tax can therefore never be greater than the difference between 80 percent of corporation surtax net income, computed without the applicable credits, and the income tax imposed by Chapter 1. The issue in this case is as to the proper determination of corporation surtax net income for purposes of this so-called 80 percent limitation. That is, whether in the cases of such as the present one, where income is being reported on the completed contract method for purposes of the Chapter 1 tax, and on the percentage of completion

tax for the excess profits tax, where the corporation surtax net income is to be determined by computing income from long term contracts on the percentage of completion method of accounting, as Respondent contends, or on the completed contract method of accounting as Petitioner contends.

The election provided in Section 736 is to report the income from long term contracts on the percentage of [94] completion method of accounting for purposes of the tax proposed by sub-chapter E of chapter 2; that is, for purposes of excess profits tax and Respondent's position is that the statute means, rather that this means for every factor necessary for the determination of the excess profits tax, and corporation surtax net income as used in Section 710 (a) (1) B. That is, the 80 percent limitation is a factor in the determination of the excess profits tax.

Respondent's position therefore is that the statute requires, that the proper interpretation of the statute is that corporation surtax net income must be determined by computing income from long term contracts on the percentage of completion method of accounting for purposes of this 80 per cent limitation; not only, however, does Respondent contend that his position represents the correct interpretation of the statute without any regard to regulations, but in this case the applicable regulations clearly provide a rule consistent with the position which Respondent is here taking, that the regulations clearly state that for the purposes of the 80 per cent limitation corporation surtax net income

is determined by computing income from long term contracts on the percentage of completion method of accounting.

I don't think that Petitioner contends here that this case does not fall within the regulations. I believe there is no disagreement here as to applicability of the regulations. [95] This is not a question of interpretation of regulations, but a question of the validity of the regulations.

Petitioner cannot be sustained in this case unless this Court holds the regulations to be invalid.

Respondent will show on brief that the regulations are reasonable and are not inconsistent with the statute.

Along this line, I should like at this point, however, to point out to the Court that both Petitioner's position and Respondent's position cut both ways. That is, both positions can in some cases benefit the taxpayer and in other cases benefit the government. In this particular case Respondent's position benefits the government; I say "benefit", I mean so far as deficiency and revenue is concerned, and is not of benefit to the taxpayer, the petitioner here. In other cases, Petitioner's position here would be detrimental to the government's case, and the government's position would be beneficial to the taxpayer.

I believe it important to emphasize, if your Honor please, that both of these rules here, both of these positions, can work out in favor of the government or in favor of the taxpayer. It is almost

fortuitous as to one case or another whether it will result in a deficiency or a refund.

The Respondent's position, however, on this issue, is that not only does his position here represent the correct interpretation of the statute, without any regard to regulations, [96] but that in any event it is clearly supported by regulations which are reasonable and which are not inconsistent with the statute and therefore, under a long line of decisions, such regulations must be sustained.

Now, I would like to comment, if I may, on Petitioner's statement with respect to the West End Furniture Company case. It is true as Petitioner has stated, that this Court in its original opinion in that case stated a rule which is contrary to the rule or to the position advanced by Respondent here, and is consistent with the rule advanced by the Petitioner. The Court, however, did not state in its opinion that it was overruling the regulations. The point was never urged before the Court; it was not in the pleadings; it was never briefed, and upon analysis of the case, it appeared that the language of the Court probably was dictum.

The Court entertained a motion to delete that portion of the opinion and that motion was granted and order entered deleting that portion of the opinion. I should like to emphasize, if I may, that that point never was presented to the Court and never was briefed by either party.

With respect to the second issue in the case, the Section 26 (e) credit, the credit provided in Section 26 (e) is a credit for income subject to the

excess profits tax, and is a factor in determining the amount of income subject to the income tax; that is, subject to the normal tax and subject [97] to the surtax. In general, that credit is equal in amount in an adjusted excess profits net income, but in a case such as the present where the taxpayer has exercised an election, the credit is equal to ten-ninths of the excess profits tax imposed under sub-chapter (e) of Chapter 2. The question is therefore, was the excess profits tax imposed for the given year for purposes of determining the credit first in Section 26 (e), and this again comes down to the question of whether the income is to be determined on the completed contract method of accounting or on the percentage of completion method of accounting.

The statute provides, if the Court please, that for purposes of the Section 26 (e) credit, or rather for purposes of determination of the tax imposed by Chapter 1, any portion of the excess profits tax which is attributable to the taxpayer's having exercised his election under Section 736; that is, any amount of excess profits tax under the percentage of completion method over what the tax would have been on the completed contract method, shall be considered to be part of the tax for the year in which the income was reported, would have been reported, the completed contract method.

If I may illustrate: If a taxpayer for the year 1942 had $100 of excess profits tax imposed on the completed contract method, and $110 on a percentage of completion method, and that $10 difference

was attributable to a contract completed [98] in 1942, Respondent's position is that the statute provides that that $10 shall be considered to be excess profits tax for the year 1944 for purposes of determining the Section 26 (e) credit. We believe that what the statute comes down to is that where the excess profits tax computed under Section 736 (b); that is, on the percentage of completion method of accounting, is greater than the excess profits tax computed on the completed contracts method of accounting, that are for purposes of determining the credit under Section 26 (e), that is, the credit for income subject to the excess profits tax, the excess profits tax imposed shall be the tax imposed on adjusted excess profits net income determined by computing income from the completed contract method of accounting.

I should like to point out to the Court that this does not mean that the taxpayer loses the benefit of the additional excess profits tax, that is, the difference between the tax as imposed on the two methods, because the tax is then attributable to the year in which it would be reported. That is, in which the income would be reported on a completed contract method of accounting. My example, a taxpayer would receive the benefit of that $10 in '44 in determining its credit.

On this issue, also, Respondent's position is that the statute's proper interpretation, without regard to any regulations, is in accordance with the Respondent's position. [99] However, here again Respondent believes that the regulations the appli-

cable regulations, squarely support his position, and that the regulations again are reasonable and are not inconsistent with the statute. And Respondent believes that his position on this issue also should be sustained both because his position represents the correct interpretation of the statute without regard to any regulations, and secondly because regulations which are reasonable and which are not inconsistent with the statute squarely support his position.

If I may, I should like to make one more comment on the first issue. Counsel for petitioner has raised the question of the position of the Chief of Staff of the Joint Committee on this 80 percent limitation question. When counsel seeks to introduce evidence with respect to that matter, the Respondent will have various objections to make to such evidence, but I should like at this point to point out merely that Respondent believes that it is the function of this Court to determine what is the proper interpretation of the statute and also whether the regulations are valid under the statute.

I believe that concludes Respondent's statement with respect to his position, if the Court please.

The Court: Do you have a stipulation?

Mr. Horrow: Yes, your Honor.

If the Court please, the parties have entered into [100] a stipulation of facts which we wish to file in duplicate.

The Court: You may submit it.

(The stipulation is received.)

Mr. Horrow: I ask the Respondent's counsel to

produce the original income and declared value excess-profits tax return, Form 1120, filed by the Petitioner for the year 1942.

(Mr. Raum producing same.)

Mr. Horrow: Your Honor, I offer in evidence as Petitioner's Exhibit the tentative and completed "Corporation income and declared value excess profits tax return," Form 1120, filed by the Petitioner for the year 1942.

The Court: Are there any exhibits attached to the stipulation?

Mr. Horrow: No, your Honor.

The Court: There is no objection?

Mr. Raum: No objection, your Honor, but since the return comes from Respondent's files, I should like to reserve the right to withdraw the return from the exhibit and substitute a photostatic copy therefor. Counsel for both parties will arrange to have a photostatic copy substituted.

The Court: That may be done. A full size photostatic copy will be furnished.

Mr. Raum: Respondent has the privilege of withdrawing the exhibit, though? [101]

The Court: Yes.

The Exhibit will be marked No. 1.

(The Return above-referred to was received in evidence and marked Petitioner's Exhibit No. 1.)

Mr. Horrow: I ask that Respondent's counsel produce the original excess profits tax return,

Form 1121, together with a tentative return filed by the Petitioner for the year 1942.

(Mr. Raum producing same.)

Mr. Horrow: I offer in evidence the original tentative and completed "Corporation excess profits tax return," Form 1121, filed by the Petitioner, for the year 1942.

Mr. Raum: No objection, your Honor, with the same reservation for withdrawing the Exhibit.

The Court: It will be done. Exhibit 2.

(The Return above-referred to was received in evidence and marked Petitioner's Exhibit No. 2.)

Mr. Horrow: I ask that Respondent's counsel produce the original claim for refund filed by the Petitioner with respect to its excess profits tax for the year 1942.

(Mr. Raum producing same.)

Mr. Horrow: I wish to offer in evidence the original Claim filed by Petitioner with respect to said tax, Form [102] 843.

Mr. Raum: No objection, your Honor, with the same reservation about withdrawing the Exhibit.

The Court: Exhibit 3. It may be withdrawn.

(The Claim above-referred to was received in evidence and marked Petitioner's Exhibit No. 3.)

PETITIONER'S EXHIBIT No. 3

Form 843—Treasury Department, Internal Revenue Service (Revised April 1940)

The Collector will indicate in the block below the kind of claim filed in the certificate on the reverse side.

[Stamp]: Received 22 Jun. 1945, Claims Control Section.

2977005 1943-Jun-400309

1942

CLAIM

To be filed with the Collector where assessment was made or tax paid

The Collector will indicate in the block below the kind of claim filed in the certificate on the reverse side.

[ ] Refund of Tax Illegally Collected.
[ ] Refund of Amount Paid for Stamps Unused, or Used in Error or Excess.
[ ] Abatement of Tax Assessed (not applicable to estate or income taxes).

State of California,
County of Napa—ss.

Name of taxpayer or purchaser of stamps: Basalt Rock Company, Inc.

Business address: 8th and River Streets, Napa, California.

The deponent, being duly sworn according to law, deposes and says that this statement is made on be-

half of the taxpayer named, and that the facts given below are true and complete:

1. District in which return (if any) was filed: 1st California. 1121-4

2. Period (if for income tax, make separate form for each taxable year) from Jan. 1, 1942, to Dec. 31, 1942.

3. Character of assessment or tax: Excess Profits Tax.

4. Amount of assessment, $1,268,998.53; dates of payment: Quarterly—1943.

5. Date stamps were purchased from the Government.....

6. Amount to be refunded: $530,996.76.

7. Amount to be abated (not applicable to income or estate taxes).....

8. The time within which this claim may be legally filed expires, under Section 322 IRC, on March 15, 1946.

The deponent verily believes that this claim should be allowed for the following reasons:

The taxpayer contends that Section 35.736(b)-3 of the Commissioner's Regulations 109 is invalid insofar as it requires that taxpayer's electing to report income from long-term contracts under the provisions of Section 736(b) of the Internal Revenue Code shall include income from long-term contracts upon a percentage method of accounting for the purpose of computing surtax net income under the provisions of Section 710(a)(1)(B). The taxpayer contends that its excess profits tax should be computed

as shown in Statement A attached hereto and made a part hereof.

BASALT ROCK COMPANY, INC.
By /s/ A. T. STREBLOW,
President.

Sworn to and subscribed before me this 12th day of April, 1945.

(Seal) /s/ JOHN R. ANDERSON,
Notary Public in and for the County of Napa, State of California.

CERTIFICATE

[Initialed]: RCM HLR

I certify that an examination of the records of this office shows the following facts as to the assessment and payment of the tax: (Show, in the ninth column, by symbols "Pd.," "Ab.," or "Cr.," the nature of each entry in the eighth column.)

List	Assessment List Month	Year	Account No. or Line	Page	Amt. assessed
1943	Jun	1942	400309		$1,268,998.53
			Total		$1,268,998.53

Paid, Abated, or Credited Date	Amount	Pd. Ab. Cr.
3-15-43	$333,042.61	pd.
3- 7-43	634,499.27	pd.
6-15-43	301,456.65	pd.
Total	$1,268,998.53	

* * * *

JAMES G. SMYTH,
Collector of Internal Revenue.
By /s/ [Illegible]
Deputy Collector, First California

* * * *

STATEMENT A

Basalt Rock Company, Inc. Claim for Refund 1942

COMPUTATION OF NORMAL TAX:		
Normal Tax Net Income—Before credit under Section 26(e)—per Revenue Agent's Report 2/19/45		$ 922,501.21
Net Income Subject to Excess Profits Tax		2,127,627.20
Excess Profits Net Income per Revenue Agent's Report 2/19/45	$ 2,283,254.50	
Less	155,627.30	
Specific Exemption $ 5,000.00		
Excess Profits Credit 150,627.30		
Balance Subject to Normal and Surtax		None
COMPUTATION OF EXCESS PROFITS TAX UNDER SECTION 710(a)(1)(B):		
Surtax Net Income before deducting credit under Section 726(e), Revenue Agent's Report 2/19/45		$ 922,501.21
80%		$ 738,001.77
Normal Tax		None
Excess Profits Tax		$ 738,001.77
Excess Profits Tax assessed on basis of original return		1,268,998.53
Overpayment		$ 530,996.76

This claim was prepared by Fred H. Brown of the firm of Lester Herrick and Herrick, Certified Accountants, and the facts herein contained he believes to be true.

/s/ FRED H. BROWN.

Mr. Horrow: If your Honor please, at this time I wish to offer in evidence as Petitioner's Exhibit next in order, the original opinion of the

Tax Court in the West End Furniture Company case, promulgated March 22, 1946, 6 Tax Court No. 71.

Mr. Raum: I object, your Honor. The Court's motion was granted deleting a portion of that opinion and we do not believe that the opinion prior to the motion is material in this case. Whether the Court granted its motion deleting that portion of the opinion, we believe that it no longer may be admitted as evidence in this case.

The Court: It is questionable whether it is proper evidence, but in accordance with the Petitioner's theory of the case we will admit it as an Exhibit.

Mr. Horrow: Thank you, your Honor.

The Court: Exhibit 4.

(The opinion above-referred to was received in evidence and marked Petitioner's Exhibit No. 4.) [103]

PETITIONER'S EXHIBIT No. 4

The Tax Court of the United States

West End Furniture Co., Petitioner, v. Commissioner of Internal Revenue, Respondent.

Docket No. 5688. Promulgated March 22, 1946.

Petitioner computed its normal tax net income on the installment basis. It computed its excess profits tax on the accrual basis, pursuant to section 736 (a) of the Internal Revenue Code. Held, that the credit to which petitioner is entitled by section 26 (e) for "income subject to excess profits tax"

must be computed on its accrual basis net income, rather than its installment basis net income; held, further, that the credit provided by section 26 (e) is the amount equal to its adjusted excess profits net income, and not, under facts of this case, the amount of the excess profits tax net income upon which an excess profits tax was actually paid.

A. Allen Simon, Esq., for the petitioner.

William H. Best, Jr., Esq., for the respondent.

The Commissioner determined a deficiency in petitioner's income tax for the calendar year 1942 in the amount of $5,119.36. Petitioner claimed a refund in the amount of $13,941.14, subject to an admitted offset of $1,253.36 for excess profits tax for 1942. By his amended answer, respondent asserted an additional deficiency in the amount of $1,053.88. The question at issue is whether or not petitioner is entitled to a credit under section 26 (e) of the Internal Revenue Code, and, if so, the correct amount thereof. A further question as to the amount or the deduction for Pennsylvania income taxes is admittedly a matter of computation.

FINDINGS OF FACT

Petitioner is a Pennsylvania corporation, with its principal place of business at Philadelphia. It filed its corporation income and declared value excess profits tax return and its corporation excess profits tax return for the taxable year 1942 with the collector of internal revenue for the first district of Pennsylvania, at Philadelphia.

Petitioner is engaged in the business of selling

furniture at retail, principally on the installment plan. Its normal tax net income for [162] 1942 reported for taxation was determined under the method of computing profit from installment sales, which method of accounting was customarily employed by petitioner with the assent of the Commissioner of Internal Revenue.

It established that the average outstanding installment accounts receivable at the end of each of the four taxable years preceding the first taxable year beginning after December 31, 1941, was more than 125 per cent of the amount of such accounts receivable at the end of the taxable year 1942. At the time it filed its excess profits tax return for 1942, petitioner elected to compute its excess profits tax under section 736 (a) of the Internal Revenue Code, as amended. It filed supplemental tax returns for 1940 and 1941, in which its excess profits taxes for those years were adjusted to reflect excess profits net income computed on the accrual basis instead of the installment basis, for the purpose of complying with the requirements of section 736 (a). This adjustment, as computed by petitioner, resulted in additional excess profits taxes for 1940 and 1941, in the amount of $8,229.81, and a decrease of $1,256.06 in normal income tax. The difference was paid.

The amount of petitioner's net income for 1942, computed on the installment basis, prior to the deduction of the Pennsylvania corporate net income tax, was $77,449.52. The amount of its net income for 1942, computed on the accrual basis pursuant to section 736 (a), was $32,705.40.

The deficiency of $5,119.36 as originally determined largely arose by reason of respondent's disallowance of a credit taken on petitioner's amended income and declared value excess profits tax in the amount of $9,032.04 as "income subject to excess-profits tax" under the provisions of section 26 (e) of the Internal Revenue Code and the allowance of a credit in lieu thereof in the sum of $2,565.84. The discrepancy between these two figures was caused by a difference in the amounts used by the parties in making their calculations in regard to two items, (1) the Pennsylvania corporate income tax payable by petitioner and (2) the excess profits credit; i. e., the respondent calculated this credit on the average earnings methods while the petitioner calculated this credit on the invested capital method. The calculations of both parties were made on the assumption that the petitioner's adjusted excess profits tax net income and the consequent credit to be allowed therefor under section 26 (e) were to be ascertained under the accrual method provided by section 736 (a). Petitioner does not now question the propriety of respondent's using the average earnings method in his calculations, and both parties agree that the amount of the Pennsylvania corporate income tax must be later determined in computations to be made after the decision herein. [163]

Petitioner now contends not only that respondent erred in this determination of deficiency, but also that it is entitled to a refund. It now alleges that it is entitled to a credit under section 26 (e),

not in the amount of $9,032.04 as claimed in its amended return, or of $2,565.84 as allowed by respondent in his determination of deficiency, but in the amount of $42,688.33. It bases this contention on the position that the credit for "income subject to excess profits tax" which it is entitled to use in computing its normal tax and surtax net income under section 26 (e) is to be calculated by using as "net income" its net income figured on the installment basis rather than its net income figured on the accrual basis, as provided by section 736 (a).

Respondent, by amended answer, now contends that the credit of $2,565.84 was erroneously allowed, since petitioner had no income which was subject to excess profits tax in that year.

Because it may be pertinent to the final computation of petitioner's tax liability, the following facts relating to petitioner's returns are set out below.

Petitioner's amended excess profits tax return, filed on Form 1121, so far as it is necessary to set it out here, reflects the following items and computations:

1.	Excess profits net income		$ 27,299.42
2.	Specific exemption	$ 5,000.00	
4.	Excess profits credit (Inv. cap.)	13,267.38	
6.	Total		18,267.38
8.	Adjusted excess profits net income		9,032.04
9.	90% of Item 8		8,128.84
12.	Surtax net income (without 26 (e) credit)		64,992.88
13.	80% of item ~~12~~ 1-Sch. A $29,367.90 plus $99.95 U. S. interest—$29,467.85		23,574.28
14.	Income tax under Chap. 1		25,973.16
15.	Excess item 13 over item 14		.....
16.	Item ~~013~~ ~~or item 15~~, whichever is lesser		23,574.28
24.	Excess profits tax due		None

Its amended income and declared value excess profits tax return reflected the following information:

	Gross Income	
3.	Gross profits from sales	$184,036.12
14.	Other income	10,041.37
15.	Total income	$194,077.49
	Deductions	
16 to 29.	[Since these are not in dispute, only the total is shown here]	$120,152.52
31.	Net income for declared value excess-profits tax computation	$ 73,924.97
32.	Add interest on certain U. S. obligations	99.95
33.	Total lines 31 and 32	$ 74,024.92
35.	Net income	74,024.92
36.	Less interest on certain U. S. obligations	99.95
37.	Adjusted net income	$ 73,924.97
38.	Less: Income subject to excess profits tax	9,032.04
40.	Normal-tax net income	64,892.93
	Total Income and Declared Value Excess Profits Taxes	
41.	Total income tax	$ 25,973.16
	Limited to 80% of $29,467.85 profit on installment basis—see excess profits return—Form 1121.	
45.	Total income and declared value excess profits taxes due	23,574.28

Item 13 of the amended excess profits tax return reflects an item which is erroneous in amount, resulting from an unauthorized departure from the requirements of the statute as reflected in the printed Form 1121; and item 43 of the amended income and declared value excess profits tax return erroneously labels that figure as 80 percent of profit on installment basis, rather than on accrual basis, which it was.

OPINION

Kern, Judge: The issue before us is whether petitioner, in computing its normal and surtax net income, is entitled to a credit under section 26 (e) of the Internal Revenue Code, and, if so, in what amount.

That section relates to credits allowed in the computation of corporate normal tax net income and surtax net income, and reads as follows:

Sec. 26. Credits of Corporations.

In the case of a corporation the following credits shall be allowed to the extent provided in the various sections imposing tax * * *.

* * * *

(e) Income Subject to Excess-Profits Tax.—In the case of any corporation subject to the tax imposed by Subchapter E of Chapter 2, an amount equal to its adjusted excess-profits net income (as defined in section 710 (b). * * *[1]

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[1] The omitted part of this subsection reads as follows: "In the case of any corporation computing such tax under section 721 (relating to abnormalities in income in the taxable period), section 726 (relating to corporations completing contracts under the Merchant Marine Act of 1936), section 731 (relating to corporations engaged in mining strategic minerals), or section 736 (b) (relating to corporations) with income from long-term contracts), the credit shall be the amount of which the tax imposed by such subchapter is 90 per centum. For the purpose of the preceding sentence the term 'tax imposed by Subchapter E of Chapter 2' means the tax computed without regard to the limitation provided in section 710 (a) (1) (B) (the 80 per centum limitation), without regard to the credit provided in section 729 (c) and (d) for

Section 710 (b), referred to, provides as follows:

As used in this section, the term "adjusted excess profits net income" in the case of any taxable year means the excess profits net income (as defined in section 711) minus the sum of:

(1) Specific Exemption.—A specific exemption of $5,000.

(2) Excess Profits Credit.—The amount of the excess profits credit allowed under section 712; and

(3) Unused Excess Profits Credit.—The amount of unused excess profits credit adjustment for the taxable year, computed in accordance with subsection (c).

Section 711 provides:

The excess profits net income for any taxable year beginning after December 31, 1939, shall be the normal-tax net income, as defined in section 13 (a) (2), for such year, except that the following adjustment shall be made: * * *

Section 13 (a) (2) defines "normal-tax net income" as "the adjusted net income" as defined in section 13 (a) (1) minus the credits for income subject to the tax imposed by subchapter E of chapter 2 provided in section 26 (e) and dividends received. Section 13 (a) (1) defines "adjusted net income" as net income minus the credit relating to interest on certain governmental obligations. Thus, the first figure with which excess profits tax computations begin is net income.

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foreign taxes paid, and without regard to the adjustments provided in section 734. This subsection shall not apply to any corporation exempt from such tax under section 725 or section 727."

Petitioner is in the business of selling furniture at retail, largely on the installment plan. Its net income, for income tax purposes, is therefore computed on the installment basis, under the provisions of section 44 (a) of the Internal Revenue Code, the provisions of which do not enter into the dispute. Its net income, so computed, amounted to approximately $75,000 in 1942.

For excess profits tax purposes, however, petitioner elected to compute its income on an accrual basis instead of an installment basis, as authorized by section 736 (a) of the Internal Revenue Code. [2]

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[2] Sec. 736. Relief for Installment Basis Taxpayers and Taxpayers with Income from Long-term Contracts.

(a) Election to Accrue Income—In the case of any taxpayer computing income from installment sales under the method provided by section 44 (a), if such taxpayer establishes, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, that the average volume of credit extended to purchasers on the installment plan in the four taxable years preceding the first taxable year beginning after December 31, 1941, was more than 125 per centum of the volume of such credit extended to such purchasers in the taxable year, or the average outstanding installment accounts receivable at the end of each of the four taxable years preceding the first taxable year beginning after December 31, 1941, was more than 125 per centum of the amount of such accounts receivable at the end of the taxable year, or if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence, in either case including only such years for which the income was computed under the method provided in section 44 (a), it may elect, in its return for the taxable year, for the purposes of the tax imposed by this sub-

This was a relief provision enacted by Congress in 1942 for the purpose of providing excess profits tax relief to taxpayers in the installment sales business. Petitioner was able to fulfill the requirements of the statute to establish its eligibility, about which there is no dispute, and accordingly it computed its income for excess profits tax purposes on an accrual basis. This resulted in an adjusted

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chapter, to compute, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, its income from installment sales on the basis of the taxable period for which such income is accrued, in lieu of the basis provided by section 44 (a). Except as hereinafter provided, such election shall be irrevocable when once made and shall apply also to all subsequent taxable years, and the income from installment sales for each taxable year before the first year with respect to which the election is made but beginning after December 31, 1939, shall be adjusted for the purposes of this subchapter to conform to such election. In making such adjustments, no amount shall be included in computing excess profits net income for any excess profits tax taxable year on account of installment sales made in taxable years beginning before January 1, 1940. If the taxpayer establishes, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, that in a taxable year subsequent to the year with respect to which an election has been made under the preceding provisions of this subsection it would not be eligible to elect such accrual method, the taxpayer may in accordance with such regulations elect in its return for such year to abandon such accrual method. Such election shall be irrevocable when once made and shall preclude any further elections under this subsection. For the taxable year for which the latter election is made and subsequent taxable years, income shall be computed in accordance with section 44 (c).

excess profits net income in the amount of $9,032.04, according to petitioner's excess profits tax return, but in no excess profits tax due, because of the 80 percent limitation imposed by the statute. Petitioner then used the $9,032.04 figure as its 26 (c) credit in computing its income tax liability. In his notice of deficiency, respondent disallowed the credit claimed in that amount and allowed a credit in the amount of $2,565.84. However, when the petition was filed in this proceeding, petitioner advanced beyond its original contention and assumed the position that it was entitled to a credit under section 26 (e) in the amount of $42,688.33. This claim was based on its interpretation of the sections of the statute, quoted above, which allow a credit in the amount of its adjusted excess profits net income, which, in turn, is made to depend on the amount of the normal tax net income. Petitioner therefore now contends that it is entitled to a credit under section 26 (e) in the amount of adjusted excess profits net income which would result from making the adjustments prescribed by section 711 and section 710 to the normal tax net income on which its income tax liability was based, which was computed on an installment basis, notwithstanding its election to compute its excess profits tax liability on an accrual basis.

Respondent has also gone beyond his earlier position, and has filed an amended answer, asserting an increased deficiency based upon his present theory that, although by his own computation, petitioner has an "adjusted excess profits net income"

in the amount of $2,565.84, it is not entitled to any credit under section 26 (e) because it did not pay any excess profits tax.

Considering first the petitioner's contention, it is essentially this: It computes its income tax on the installment basis and its excess profits tax on the accrual basis. In computing its income tax liability, it is entitled to a credit equal to the amount of its adjusted excess profits net income, as defined in section 710 (b). Section 710 (b) refers to section 711 (a), which defines excess profits net income as normal tax income with certain adjustments. Therefore, petitioner reasons, it is entitled to take its normal tax net income, computed on an installment basis, make the adjustments required by sections 710 (b) and 711 (a), and use the resulting figure as its "adjusted excess profits net income" credit in computing its income tax liability, although it elected to compute its adjusted excess profits net income for excess profits tax purposes on the accrual basis.

Petitioner's chief argument on this point is based on its construction of section 711 (a), which, it contends, requires, by its plain language, the use of its normal tax net income (which, of course, is computed on the installment basis) as a basis for its excess profits net income. It argues that the statute says the excess profits net income shall be normal tax net income, with certain adjustments; that its normal tax net income is computed on the installment basis; and that that figure, therefore, is the one which must be used in the computation

of the excess profits tax net income which forms the basis for the credit under 26 (e). It attacks, as contrary to the statute, respondent's Regulations 112, section 35.736(a)-3, which provides that the credit shall be computed on the accrual basis.[3]

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[3] Sec. 35.736 (a)-3 Computation of Income on Straight Accrual Basis.—If the taxpayer has elected under section 736 (a) and section 35.736 (a)-2 to compute for excess profits tax purposes its income from installment sales on the basis of the taxable year for which such income is accrued, in lieu of the basis provided by section 44 (a), the gross income of the taxpayer from installment sales shall be computed upon such accrual basis. * * *

If an election is made under section 736 (a) and section 35.736 (a)-2 for an excess profits tax taxable year beginning after December 31, 1941, or for a subsequent taxable year, to compute excess profits net income on the straight accrual basis in lieu of the installment basis, the following rules shall apply with respect to a taxable year beginning after December 31, 1941: The normal tax and surtax determined under Chapter 1 shall be based upon normal tax net income and surtax net income which include income from installment sales computed under the method provided by section 44 (a), and the excess profits tax shall be determined upon the basis of adjusted excess profits net income which shall include income from installment sales computed upon the straight accrual basis as described in this section. The normal tax net income and the corporation surtax net income for the purposes of the normal tax and surtax under Chapter 1 shall be determined by using as the credit under section 26 (e) (relating to income subject to excess profits tax) the amount of adjusted excess profits net income computed by determining income from installment sales upon the straight accrual basis. For the purposes of determining the excess profits tax under section 710 (a) (1) (B), as an amount which when added to the normal

A careful analysis of the statute demonstrates the fallacy of petitioner's argument.

In section 711 is found the first step required for the computation of excess profits tax liability. That first step is to take the normal tax net income and make the several adjustments required there. After these and other adjustments provided by section 710 are made, the resulting figure is the amount upon which excess profits tax is paid. Petitioner elected under 736 (a) "to compute its income from installment sales on the basis of the period for which such income is accrued" for excess profits tax purposes, instead of the installment basis which it uses for income tax purposes. For that reason, in its case, when it computed its excess profits tax liability, the normal tax net income referred to in section 711 (a) was a normal tax net income computed on the accrual basis, not the normal tax net income computed on the installment basis on which it paid its income tax. Otherwise, its purported election would be meaningless and ineffective. It is thus impossible to escape the conclusion that the term "normal-tax net income" as

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tax and surtax for such year equals 80 per cent of the corporation surtax net income computed without regard to the credit under section 26 (e) the corporation surtax net income shall include income from installment sales computed upon the straight accrual basis described in this section, the credit for dividends received used in computing corporation surtax net income shall be limited to 85 percent of the net income which shall include income from installment sales computed upon such straight accrual basis, and the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1.

used in section 711 (a) does not, in and of itself, and in every case, mean the normal tax net income used for income tax purposes. In the case of a taxpayer who has elected to compute his excess profits tax on an accrual basis, the normal tax net income which is an integral factor in such computation must necessarily be computed also on the accrual basis, in order to give any effect whatever to the election. We, therefore, hold that the credit to which petitioner is entitled under section 26 (e) is in an amount equal to its adjusted excess profits net income computed on the accrual basis by virtue of its election under section 736 (a).

Turning now to respondent's objection to the allowance of any credit whatever, we note the following pertinent factors. Attached to the notice of deficiency was respondent's calculation of petitioner's tax liability, and that computation showed petitioner's "adjusted excess-profits net income to be $2,565.84. Although respondent allowed this amount as a credit under section 26 (e), he made no determination of deficiency in petitioner's excess profits tax. Respondent, having allowed the credit provided for in section 26 (e) in the amount of $2,565.84, now claims the credit was erroneously allowed and that no credit should be allowed because petitioner had no income subject to excess profits tax.

In opposition to respondent's demand for an increased deficiency, petitioner points to the fact that respondent's original calculation, which allowed the credit of $2,565.84, was in exact accord

with respondent's own regulation, section 35.736 (a) of Regulations 112. Petitioner refers to an illustrative case contained in the regulation in which a 26 (e) credit was allowed in the amount of "adjusted excess profits net income" in computing normal and surtax income, even [169] though the excess profits tax actually paid was in a different amount by reason of the 80 percent limits provisions of section 710 (a).

Petitioner's objections to the position which respondent now assumes by amended answer are well founded. The regulation referred to supports petitioner's argument, and, in addition, correctly interprets the statute.

The extensive argument which petitioner directed toward the first problem involved in this case, which we have already decided, might, we think, more properly have been aimed at this phase of the case. Section 26 (e) provides for a credit in "an amount equal to its adjusted excess-profits net income," except that, in four types of corporations, "the credit shall be the amount of which the tax imposed by such subchapter is 90 percentum."

This would seem to indicate a legislative intent that only in those four exceptional cases (which do not apply to petitioner) is the credit to be measured by the amount of income on which the tax is actually imposed. In all other cases, the credit is to be in the amount of the adjusted excess profits net income, whether or not the tax was actually imposed on that amount.

It may be pointed out that in our opinion, as we shall later explain, the petitioner was, in reality, subject to the imposition of an excess profits tax, since it had an adjusted excess profits net income, even though the respondent failed to impose it.

We are convinced that there is no statutory basis for the respondent's refusal to allow a credit in the amount of petitioner's adjusted excess profits net income.

Petitioner, in its amended excess profits tax return, filed on Form 1121, at item 13, computed the 80 percent limitation provided for in section 710 (a)(1)(B) of the code on the basis of a surtax net income computed on the accrual basis, instead of the installment basis upon which its surtax net income was actually computed. The resulting figure was 23,574.28, and, since petitioner's income tax imposed by chapter 1 of the code was of itself in excess of that figure, petitioner concluded that it owed only $23,574.28 in income taxes, and no excess profits tax. It should, however, be pointed out that an erroneous figure was used by petitioner in arriving at the amount which purported to be the limit of income and excess profits taxes which could be imposed by reason of section 710 (a) (1) (B). Its surtax net income, computed under section 15 as section 710 (a) (1) (B) provides, was computed on the installment basis, and is 80 percent of that figure which is the limit imposed by section 710 (a) (1) (B). In petitioner's later computation of its tax liability, contained in Exhibit B attached to its petition, this factor is not set forth, and is of

no importance, because the resulting total of its computed liability for [170] income and excess profits tax is well below that limit. But, since petitioner arrived at that low figure by claiming a credit of $42,688.33 which we have held was greatly in excess of the credit to which it was entitled, and since it appears that a proper computation of its liability in accord with our opinion in this case will result in a total income and excess profits tax liability in excess of the amount which petitioner contends is the limit to which it may be subjected but within the limitation as properly computed, and, further, since it appears from respondent's calculation (though no express statement to that effect appears therein) that respondent is giving effect to that 80 per cent limitation erroneously claimed by petitioner, the point is made at this time in order to prevent any dispute concerning this item as a limitation upon the amount of the taxes to be computed pursuant to this opinion.

Decision will be entered under Rule 50. [171]

Mr. Raum: May I have an exception?

The Court: It is still in our file. You may.

Mr. Horrow: At this time I wish to offer in evidence as Petitioner's Exhibit next in order a motion filed by the Commissioner in the case referred to, Docket No. 5688, for the deletion of certain portions of the Court's opinion, together with a motion for leave to file a second motion, and the order of the Court filed with respect to the amended motion.

Mr. Raum: Respondent objects, your Honor, on the ground that it is irrelevant and immaterial.

The Court: It will be received as Exhibit 5.

(The Motion above-referred to was received in evidence and marked Petitioner's Exhibit No. 5.)

PETITIONER'S EXHIBIT No. 5

The Tax Court of the United States
Washington

Docket No. 5688

WEST END FURNITURE CO.,
Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

ORDER

By leave of Court, respondent filed herein a Motion for Deletion of Certain Portions of the Court's Opinion Promulgated March 22, 1946. On July 24, 1946, counsel for petitioner informed the Court in writing that he had no objection to the granting of said motion. Therefore, upon due consideration, it is

Ordered: That said motion be and it hereby is granted; and it is further and accordingly

Ordered: That the language of our opinion quoted in said motion be and it hereby is deleted from our opinion herein.

/s/ JOHN W. KERN,
Judge.

August 7, 1946. [172]

The Tax Court of the United States

Docket No. 5688

[Title of Cause.]

MOTION FOR LEAVE TO FILE MOTION FOR DELETION OF CERTAIN PORTIONS OF OPINION

Comes now the respondent, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and

Moves for leave to file the attached motion that the Court delete certain portions of its opinion in the above-entitled proceeding, promulgated March 22, 1946, 6 T. C. No. 71, and for cause shows:

1. Rule 19 of the Court's Rules of Practice provides that no motion for rehearing, further hearing, or reconsideration may be filed more than 30 days after the opinion has been served except by special leave. The decision was entered in this proceeding May 28, 1946. No petition for review has been filed in this proceeding, but the time to file such a petition does not expire until August 28, 1946. Section 1142 of the Internal Revenue Code. Prior to such date, or prior to the date petition for review is filed, the Court has jurisdiction to reconsider its decision in this proceeding. Garden City Feeder Company, (1933) 27 B.T.A. 1132, 1145; John Thomas Smith, (1940) 42 [173] B.T.A. 505, 506; sections 1140 and 1142 of the Internal Revenue Code. It is submitted that if the Court has jurisdiction to reconsider its decision in this proceeding, a fortiori it has authority to reconsider its opinion.

2. Petitioner is engaged in the business of sell-

ing furniture at retail, principally on the installment plan. Petitioner, as authorized by sections 44 and 736 (a) of the Code, reported its income from installment sales on the installment basis for purposes of the income tax and on the accrual basis for purposes of the excess profits tax. The only issues raised by the pleading, at the hearing, and in the briefs were (1) the correct method of computing the credit for income subject to the excess profits tax, provided in section 26 (c) of the Code, in such a case, and (2) whether petitioner is entitled to a credit under section 26 (e) even though it in fact paid no excess profits tax. The Court decided both of these issues.

3. The Court in addition, anticipating a Rule 50 computation, stated in its opinion that in applying the 80-percent limitation, provided in section 710 (a) (1) (B) of the Code, corporation surtax net income should include from installment sales computed on the installment basis and not on the accrual basis. The language used by the Court is contrary to the rule provided in the regulations. Section 35.736 (a)-3 of Regulations 112 provides as follows:

* * * *

"* * * For the purposes of determining the excess profits tax under section 710 (a) (1) (B) as an amount [174] which when added to the normal tax and surtax for the taxable year equals 80 percent of the corporation surtax net income properly adjusted pursuant to the provisions of section 710 (a) (1) (B) applicable to such taxable year, the corporation surtax net income shall include in-

come from installment sales computed upon the straight accrual basis described in this section, the credit for dividends received used in computing corporation surtax net income shall be limited to 85 per cent of the net income which shall include income from installment sales computed upon such straight accrual basis, and the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1. [Underscoring supplied.]

* * * *

The proper application of the 80-percent limitation, as is more fully explained in the attached motion for deletion of certain portions of the Court's opinion herein, was not in issue in this proceeding, and the language in the opinion with reference thereto appears to be dictum. The language in question nevertheless, as in likewise explained in the attached motion, has created uncertainty both within and without the Bureau of Internal Revenue concerning the proper application of the regulations even to a case or cases coming directly within them.

Wherefore, it is prayed that this motion be granted.

/s/ J. P. WENCHEL, MBL,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:
HARTFORD ALLEN,
Division Counsel.
WILLIAM H. BEST, JR.,
LEONARD RAUM,
Special Attorneys,
Bureau of Internal Revenue. [175]

The Tax Court of the United States

Docket No. 5688

[Title of Cause.]

MOTION FOR DELETION OF CERTAIN PORTIONS OF THE COURT'S OPINION PROMULGATED MAR. 22, 1946

Comes now the respondent, by his attorney, J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue, and

Moves that the Court delete certain portions of its opinion in the above-entitled proceeding, promulgated March 22, 1946, 6 T. C. No. 71, and for cause shows:

1. If the Court grants this motion, the judgment entered by the Court will not be affected. The amount of the deficiency determined by the Court will not be changed and petitioner's rights in this proceeding will in no way be prejudiced.

2. Petitioner is engaged in the business of selling furniture at retail, principally on the installment plan. Petitioner, as authorized by sections 44 and 736 (a) of the Internal Revenue Code, reported its income from such installment sales on the installment method of accounting for purposes of the income tax and on the accrual method of accounting for purposes of the excess profits tax. The only issues raised by [176] the pleadings, at the hearing, and in the briefs were (1) the proper method of computing the credit for income subject to the excess profits tax, provided in section 26 (c) of the Code, in such a case, and (2) whether petitioner is entitled to a credit under section 26 (c)

even though it in fact paid no excess profits tax. The Court decided both of these issues.

3. The Court in addition, anticipating a Rule 50 computation, stated in its opinion that in applying the 80-percent limitation, provided in section 710 (a) (1) (B) of the Code, corporation surtax net income should include income from installment sales computed on the installment basis and not on the accrual basis. The language used by the Court is contrary to the rule provided in the regulations. Section 35.736(a)-3 of Regulations 112 provides as follows:

* * * *

"* * * For the purposes of determining the excess profits tax under section 710 (a) (1) (B) as an amount which when added to the normal tax and surtax for the taxable year equals 80 percent of the corporation surtax net income properly adjusted pursuant to the provisions of section 710 (a) (1) (B) applicable to such taxable year, the corporation surtax net income shall include income from installment sales computed upon the straight accrual basis described in this section, the credit for dividends received used in computing corporation surtax net income shall be limited to 85 per cent of the net income which shall include income from installment sales computed upon such straight accrual basis, and the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1. [Underscoring supplied.] [177]

4. The respondent asserted a deficiency with respect to income tax in this proceeding, but no deficiency was asserted with respect to the excess

profits tax. The Court accordingly has jurisdiction with respect to the income tax but has no jurisdiction with respect to the excess profits tax. The excess profits tax is the only tax to which the 80-percent limitation applies. The petitioner in its amended corporation income and declared value excess-profits tax return for the calendar year 1942 claimed that the 80-percent limitation applied to the income tax, and a collector's claim for abatement, based in part on such claim, was allowed. No such claim, however, was raised by the pleadings, at the hearing, or in the briefs as a defense to the asserted deficiency. The Court's references to the 80-percent limitation therefore appear to be dicta.

5. In connection with a case submitted by respondent to the Joint Committee on Internal Revenue Taxation, Congress of the United States, as required by section 3777 (a) of the Internal Revenue Code, proposing a refund of taxes in excess of $75,000 based on the present regulations, the Chief of Staff of the Joint Committee informed the Treasury Department that no basis for unfavorable criticism of the proposed refund had been found. Thereafter respondent presented another case of the same character, likewise proposing a refund based on the existing regulations, to the Joint Committee. In a recent communication received by the Treasury Department from the Chief of Staff [178] of the Joint Committee, the Department was advised that certain members of the Staff of the Joint Committee had raised objections to the allowing of a refund in the last-mentioned case because of the language of the Court in its opinion herein with

reference to the proper application of the 80-percent limitation, and that, although it was recognized that such language probably was dictum, the case was nevertheless being held for further consideration. Although it would appear that the Court's language in the opinion with reference to the 80-percent limitation is dictum and not necessary to the conclusions reached by the Court on the points at issue before it, the question whether the Court intended to make a holding contrary to the regulations would persist and would create serious difficulties, from the standpoint of taxpayers as well as of the Government, until squarely met in a proceeding wherein the validity of the regulations would necessarily and directly be involved.

Wherefore it is prayed that this motion be granted and that the Court delete the following language from its opinion:

(1) The last paragraph of the Findings of Fact which reads as follows:

"Item 13 of the amended excess profits tax return reflects an item which is erroneous in amount, resulting from an unauthorized departure from the requirements of the statute as reflected in the printed Form 1121; and item 43 of the amended [179] income and declared value excess profits tax return erroneously labels that figure as 80 per cent of profit on installment basis, rather than on accrual basis, which it was."

(2) The third paragraph from the end of the opinion which reads as follows:

"It may be pointed out that in our opinion, as we shall later explain, the petitioner was, in reality,

subject to the imposition of an excess profits tax, since it had an adjusted excess profits net income, even though the respondent failed to impose it."

(3) The last paragraph of the opinion which reads as follows:

"Petitioner, in its amended excess profits tax return, filed on Form 1121, at item 13, computed the 80 percent limitation provided for in section 710 (a) (1) (B) of the code on the basis of a surtax net income computed on the accrual basis, instead of the installment basis upon which its surtax net income was actually computed. The resulting figure was $23,547.28, and, since petitioner's income tax imposed by chapter 1 of the code was of itself in excess of that figure, petitioner concluded that it owed only $23,574.28 in income taxes, and no excess profits tax. It should, however, be pointed out that an erroneous figure was used by petitioner in arriving at the amount which purported to be the limit of income and excess profits taxes which could be imposed by reason of section 710 (a) (1) (B). Its surtax net income, computed under section 15 as section 710 (a) (1) (B) provides, was computed on the installment basis, and it is 80 percent of that figure which is the limit imposed by section 710 (a) (1) (B). In petitioner's later computation of its tax liability, contained in Exhibit B attached to its petition, this factor is not set forth, and is of no importance, because the resulting total of its computed liability for income and excess profits tax is well below that limit. But, since petitioner arrived at that low figure by claiming a credit of $42,688.33 which we have held was

greatly in excess of the credit to which it was entitled, and since it appears that a proper computation of its liability in accord with our opinion in this case will result in a total income and excess profits tax liability in excess of the amount which petitioner contends [180] is the limit to which it may be subjected but within the limitation as properly computed, and, further, since it appears from respondent's calculation (though no express statement to that effect appears therein) that respondent is giving effect to that 80 percent limitation erroneously claimed by petitioner, the point is made at this time in order to prevent any dispute concerning this item as a limitation upon the amount of the taxes to be computed pursuant to this opinion."

/s/ J. P. WENCHEL, MBL,
Chief Counsel, Bureau of
Internal Revenue.

Of Counsel:

HARTFORD ALLEN,
Division Counsel.

WILLIAM H. BEST, JR.,
LEONARD RAUM,
Special Attorneys,
Bureau of Internal Revenue. [181]

Mr. Raum: May I have an exception, if your Honor please?

Mr. Horrow: Your Honor, I have a letter dated December 4, 1946, from Colin F. Stam, Chief of Staff of the Joint Committee on Internal Revenue Taxation, Congress of the United States. I ask

that that be marked for identification as Petitioner's Exhibit next in order.

The Court: It will be marked Exhibit 6 for identification.

(The letter above-referred to was marked Petitioner's Exhibit No. 6 for identification.)

PETITIONER'S EXHIBIT No. 6

Congress of the United States
Joint Committee on Internal Revenue Taxation
Washington

December 4, 1946

Pillsbury, Madison & Sutro
Standard Oil Building
San Francisco 4, California

Attention: Mr. Harry R. Horrow

Gentlemen:

I am in receipt of your letter of November 29, 1946, which reads as follows:

"November 29, 1946.

Basalt Rock Co., Inc. v. Commissioner of Internal Revenue

Mr. Colin F. Stam,
Chief of Staff,
Joint Committee on Internal Revenue Taxation,
Congress of the United States,
Room 1336, New House Office Building,
Washington, D. C.

Dear Mr. Stam:

We represent the taxpayer in a case now pending before The Tax Court of the United States, Basalt Rock Co., Inc. v. Commissioner of Internal

Revenue, docket No. 10620. The principal issue in the case involves the validity of the Treasury regulations dealing with the effect on the 80 percent limitation prescribed in section 710 (a) (1) (B) of the Internal Revenue Code, if any, of an election under section 736 (b) as follows: [182]

"The excess profits tax may be computed under section 710 (a) (1) (B) as an amount which when added to the normal tax and surtax computed under Chapter 1 equals 80 percent of the corporation surtax net income computed without regard to the credit under section 26 (e) (relating to income subject to excess profits tax). For such purpose, the corporation surtax net income shall be determined by computing the income from long-term contracts upon the percentage of completion method of accounting" (Regulations 112, sec. 35.736(b)-3).

As you know, in a recent decision of The Tax Court of the United States, West End Furniture Co., the original opinion stated in part as follows:

'Petitioner, in its amended excess profits tax return, filed on Form 1121, at item 13, computed the 80 percent limitation provided for in section 710 (a) (1) (B) of the code on the basis of a surtax net income computed on the accrual basis, instead of the installment basis upon which its surtax net income was actually computed. The resulting figure was $23,574.28, and, since petitioner's income tax imposed by chapter 1 of the code was of itself in excess of that figure, petitioner concluded that it owed only $23,574.28 in income taxes, and no excess profits tax. It should, however, be pointed

out that an erroneous figure was used by petitioner in arriving at the amount which purported to be the limit of income and excess profits taxes which could be imposed by reason of section 710 (a) (1) (B). Its surtax net income, computed under section 15 as section 710 (a) (1) (B) provides, was computed on the installment basis, and it is 80 percent of that figure which is the limit imposed by section 710 (a) (1) (B).'

Thereafter the Commissioner filed a motion for deletion of the portion of the opinion set forth above, and in the statement of grounds in support of said motion stated as follows:

'In connection with a case submitted by respondent to the Joint Committee on Internal Revenue Taxation, Congress of the United States, as required by section 377 (a) [183] of the Internal Revenue Code, proposing a refund of taxes in excess of $75,000 based on the present regulations, the Chief of Staff of the Joint Committee informed the Treasury Department that no basis for unfavorable criticism of the proposed refund had been found. Thereafter respondent presented another case of the same character, likewise proposing a refund based on the existing regulations, to the Joint Committee. In a recent communication received by the Treasury Department from the Chief of Staff of the Joint Committee, the Department was advised that certain members of the Staff of the Joint Committee had raised objection to the allowing of a refund in the last-mentioned case because of the language of the Court in its opinion herein with ref-

erence to the proper application of the 80-percent limitation, and that, although it was recognized that such language probably was dictum, the case was nevertheless being held for further consideration. Although it would appear that the Court's language in the opinion with reference to the 80-percent limitation is dictum and not necessary to the conclusions reached by the Court on the points at issue before it, the question whether the Court intended to make a holding contrary to the regulations would persist and would create serious difficulties, from the standpoint of taxpayers as well as of the Government, until squarely met in a proceeding wherein the validity of the regulations would necessarily and directly be involved.'

As you know, Judge Kern of The Tax Court, there being no objection on the part of petitioner, ordered that said motion be granted and that the language of the opinion quoted in the Commissioner's motion, including the language set forth above, be deleted from the original opinion. I should appreciate very much your advising us whether the objections raised to the allowance of a refund of taxes in excess of $75,000 after the promulgation of the original opinion of the court in the West End Furniture Co. case were based on the ground that in your opinion The Tax Court's decision was correct and that the regulations set forth in section 35.736 (a)-3 and section 35.736 (b)-3 dealing with the 80 percent limitation are invalid, and that, despite the deletion of a portion of The [184] Tax Court's opinion in said case, you are still of the

same opinion, and that your present policy as Chief of Staff of the Joint Committee is to withhold approval of refunds in excess of $75,000 based on the present regulations.

Very truly yours,

PILLSBURY, MADISON & SUTRO,

By /s/ HARRY R. HORROW."

At the present time, the staff has taken the position in several refund cases pending before it that the 80 percent limitations should be computed on the basis of the corporation surtax net income computed under section 15, but without regard to the credit provided in section 26(e) relating to the income subject to the excess profits tax. Neither section 710(a)(1)(B) nor section 15 defining surtax net income provides a different method for detering the surtax net income upon which the 80 percent limitation is computed where an election, if any, is made under section 736(b) of the Internal Revenue Code relating to an election on long-term contracts.

Final decision in the matter is awaiting a conference between the staff and representatives of the Chief Counsel's office. If, as a result of such a conference the staff is still of the opinion that its present position in this respect is correct and the representatives of the Chief Counsel's office are of the opinion that their position is correct, the matter will be referred to the Joint Committee on Internal Revenue Taxation for decision. While the

Joint Committee on Internal Revenue Taxation has no authority, under the law, to approve or disapprove refunds, as a matter of practice, the Bureau of Internal Revenue has not failed to follow the decision of the Committee in any refund case.

In conclusion, I may state that the decision of the staff is not affected by the action of Judge Kern in granting a motion that certain language set forth in the original opinion of the West End Furniture Company case be deleted. Our conclusion in this matter is based entirely upon our conception of what Congress intended by use of the term corporation surtax net income computed under section 15 of the Internal Revenue Code but without regard to the credit under section 26(e) relating to income subject to the excess profits tax.

Yours sincerely,

/s/ COLIN F. STAM,
Chief of Staff. [185]

Mr. Horrow: May it be stipulated that the letter, Petitioner's Exhibit 6 for identification, is signed by Colin F. Stam and that Colin F. Stam is the Chief of Staff of the Joint Committee on Internal Revenue Taxation, Congress of the United States, and has been since 1940?

Mr. Raum: If your Honor please, as I have stated to counsel for the Petitioner previously, I raise no question on the identity of this letter. I stipulate that Mr. Stam signed that letter. To the best of my knowledge, I don't know frankly when Mr. Stam took position as Chief of Staff of the

Joint Committee; I am unable to stipulate as to that. I will waive identification of the letter, however.

Mr. Horrow: Will it be stipulated, however, that Mr. Stam is now the Chief of Staff of the Joint Committee and has been at least since 1940?

Mr. Raum: I can't say with respect to 1940, if your Honor please. I don't know.

The Court: I don't think that should be a stumbling block.

Mr. Horrow: I know it is a fact, your Honor, and I have—

Mr. Raum (Interposing): I am not trying to be technical, if your Honor please; I just don't know.

The Court: The Court knows it for a fact also.

Mr. Raum: I will so stipulate in that event.

Mr. Horrow: Thank you.

At this time I wish to offer in evidence as Petitioner's Exhibit 6 the letter referred to.

Mr. Raum: If your Honor please, Respondent objects to the receipt of Petitioner's Exhibit No. 6 marked for identification, in evidence. Respondent believes that the letter is entirely immaterial and irrelevant to the decision of the issues in this case, that it is the function of this Court to determine the proper interpretation of the statute and not the function of any other official of the government. Respondent further objects on the ground that the author of the letter is not in Court for purposes of cross examination, and that the letter is not admissible on that ground also.

The Court: The objection would seem to be insuperable.

Mr. Horrow: If your Honor please, I would like to point out some of the authorities I believe sustain our position that the letter as it has been identified is admissible in evidence. There is no question that it is the function of your Honor and the Tax Court to decide the issues in this case. The question is whether the evidence offered is relevant and material. In assisting the Court in deciding the issues, the Supreme Court in White against Winchester Country Club has referred to the fact that rules of this type are admissible in evidence, and I would like to quote from the decision in [106] this case, 315—

The Court (Interposing): What was the letter purporting to be? No one has told me what the letter purports to be.

Mr. Horrow: I would like to state, your Honor, that the letter and—

The Court (Interposing): And to whom is it addressed?

Mr. Horrow: It is addressed to counsel in this case and states the opinion of the Chief of Staff of the Joint Committee and its position and policy with respect to its functions in the administration of the Internal Revenue laws. As your Honor knows, no refund can be made by the Commissioner of any excess profits tax over $7,500 without a report to the Joint Committee on Internal Revenue Taxation, and it is the function of the Chief of Staff of the Joint Committee to comment on the

propriety of any refund in which the Commissioner has proposed.

Now, as your Honor will see from the motion which has been admitted in evidence as Petitioner's Exhibit 5, the Respondent stated that by reason of the opinion of the Court in the West End Furniture Case, the Chief of Staff of the Joint Committee was withholding approval of refunds in excess of $7,500 based on the present regulations. This letter establishes that the position of the Chief of Staff of the [107] Joint Committee and his attitude and his opinion is not affected by the withdrawal of a portion of the opinion in the West End Furniture case and the Chief of Staff is still of the opinion that the rule pronouncing that case is correct.

The Court: What about the objection that there is no opportunity for cross examination?

Mr. Horrow: If your Honor please, this letter speaks for itself. It has the same status as a letter ruling issued by the Deputy Commissioner which the Supreme Court has commented on many times in cases. In the Janick case, the Supreme Court referred to a letter of the Deputy Commissioner and the case turned on a recognition that the practice embodied in that letter was sound and was a correct interpretation of the law.

The Court: Not having all the facts of it, I can't say whether it is pertinent or not.

Mr. Horrow: Well, the issue here, your Honor, is the validity in part of a regulation. To some extent the regulations are obscure. They are in-

consistent, as I say, between various portions of the regulations, although as Respondent's counsel has pointed out there is a specific provision in the regulation that deals with the method of accounting, the elected method, and its use in connection with the 80 percent limitation. Now, in considering the validity of regulations, the Supreme Court has stated, and I would like [108] to quote from the White case against the Winchester Country Club, 315 United States 32. It is substantially contemporaneous expressions of opinion that are highly relevant and material evidence of the probable general understanding of the times and of the opinions of men who probably were active in the drafting of the statute. As such, they are entitled to serious consideration. This letter speaks for itself. It is a letter by the Chief of Staff of the Joint Committee, what his opinion is as to the proper interpretation of the law and a statement that his opinion is unaffected by what the Court did in the West End Furniture Case in withdrawing a part of his opinion.

The Court: I sustain the objection.

Mr. Horrow: At this time, your Honor, I would like to make an offer of proof. Petitioner offers to prove by Petitioner's Exhibit 6 that the Chief of Staff of the Joint Committee on Internal Revenue Taxation has taken the position that the 80 percent limitation must be computed on the basis set forth in the West End Furniture case in the original opinion thereof, which is in evidence in this case, and further that the opinion of the Chief

of Staff is unaffected by the withdrawal of a portion of the opinion in that case. This letter is also offered in proof of the administrative practice: it is also offered as an expression of opinion by an official of the government who is charged with certain functions in the drafting of the statutes which are under consideration by the Court in this case.

The Court: Is there anything further?

Mr. Horrow: I would like to take an exception to your Honor's ruling.

Now, if your Honor please—

Mr. Raum (Interposing): If your Honor please, I move that the Court reject Petitioner's offer of proof.

The Court: It is a novel procedure, in my experience. As a matter of right he may make an offer of proof.

Mr. Raum: I withdraw my objection.

The Court: At least, that is my understanding.

Mr. Raum: I withdraw my objection.

Mr. Horrow: If your Honor please, I have discussed with counsel for Respondent the matter of presenting further evidence dealing with the administrative practice with respect to the regulations that are involved in this case. Such evidence would be more conveniently presented in Washington because the officials that are charged with the administration of the provisions involved are back there. With your Honor's consent, we should like to have the case continued for further hearing in Washington for the purpose of receiving further stipulations of fact, taking further testimony or

receiving depositions concerning the administration practice which we seek to establish.

The Court: That will be done. [110]

Mr. Raum: If your Honor please, I take it that will include the receipt of any Exhibits that may be necessary also?

The Court: I assume so. You will suggest a time?

Mr. Horrow: If it is agreeable to your Honor and Respondent's counsel, I would suggest the case be continued for 60 days, or some convenient date that doesn't fall on a day when the Tax Court will be not sitting. I should think that we would be able to arrive at a stipulation of facts in that period of time, or at least to make arrangements for the taking of depositions so that we may be able to avoid the necessity of having the Court sit and hear testimony from witnesses.

The Court: Is that satisfactory to you?

Mr. Raum: That is satisfactory to me.

The Court: The case will be continued to the Washington calendar, continued 60 days, not to be set in less than 60 days, and will await the convenience of counsel for further setting.

Mr. Horrow: Thank you very much.

Mr. Raum: Thank you very much, your Honor.

The Court: Briefs and that sort of thing will be arranged at a later date.

Mr. Horrow: If we could fix a time for briefs now, why— [111]

The Court: (Interposing.) We can't very well do that until we get the case in.

Mr. Horrow: I had in mind fixing the date with reference to when the case would be submitted for decision.

The Court: Would you be able to file the briefs, first briefs at the time the case is considered first in Washington?

Mr. Horrow: I had in mind fixing the date for filing briefs at 45 or 60 days from the date the case is submitted for decision, if that is agreeable.

The Court: I believe you better leave that open.

Mr. Horrow: All right. Thank you.

Mr. Raum: I didn't hear your Honor's ruling.

The Court: Leave that open.

That concludes the submission?

We will take a brief recess.

(Whereupon, at 3:30 o'clock p.m., the hearing in the above-entitled matter was closed.)

[Endorsed]: T.C.U.S. Filed Jan. 12, 1947. [112]

Official Report of Proceedings
Before
The Tax Court of the United States

Docket No. 10620

BASALT ROCK COMPANY, INC.,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

Hearing at Washington, D. C.
Date February 12, 1947.

Courtroom No. 2,
Internal Revenue Building,
Washington, D. C.,

February 12, 1947, 11:25 a.m.

Before Hon. Ernest H. Van Fossan, Judge.

Appearances: No appearance on behalf of the Petitioner. Leonard Raum (Honorable J. P. Wenchel, Chief Counsel, Bureau of Internal Revenue), appearing on behalf of the Respondent. [114]

PROCEEDINGS

The Clerk: Docket 10620, Balsalt Rock Company, Inc.

Mr. Raum: There is no appearance for the petitioner. Leonard Raum for the respondent.

The Court: I understand you want to present the stipulation in this case?

Mr. Raum: Yes, sir, your Honor. I would like to present the final stipulation in this case.

The Court: It will be received.

Mr. Raum: If your Honor please, I would like to offer in evidence as Respondent's Exhibit A a memorandum for the Chief Counsel of the Bureau of Internal Revenue from Deputy Commissioner E. J. McLarney. A copy of this memorandum is attached to the supplementary stipulation of facts and the petitioner has stated in the supplemental stipulation that he has no objection to receipt in evidence of either the original or the copy.

The Court: How is that marked? Has it been given an exhibit number?

Mr. Raum: No, sir. In the stipulation we simply attached a copy of the memorandum and said that the petitioner has said that the petitioner has no objection to the introduction of either the original nor a copy.

The Court: It is not made a part of the stipulation? [115]

Mr. Raum: No, sir, it is not.

It was intended to be a respondent's exhibit.

The Court: I just wish to fix the exhibit number.

Mr. Raum: Respondent has submitted no other exhibits up to this date, your Honor.

The Court: Then this will be Exhibit A.

Mr. Raum: I offer an original of the memorandum in evidence.

The Court: It is received.

(The document above referred to was received in evidence and marked Respondent's Exhibit A.)

RESPONDENT'S EXHIBIT A

Bureau of Internal Revenue
Income Tax Unit

January 20, 1947

Memorandum for Mr. J. P. Wenchel
Chief Counsel
Bureau of Internal Revenue

In re: Sections 35.736(a)-3 and 35.736(b)-3 of Regulations 112 and corresponding provisions of Regulations 109

Reference is made to your memorandum dated January 14, 1947, in which you request advice as to whether it has been the purpose of this office to follow the provisions of the regulations at all times since their promulgation and whether to our knowledge there has ever been, or is now, any deviation from such purpose of disposing of cases in accord with the provisions of the regulations.

I have consulted with the Heads of the Audit Review Divisions and the Head of the Practice and Procedure Division, and they have informed me that they have never suggested or recommended that the regulations be deviated from and that to their knowledge there has never been any deviation from existing regulations in any case. This is also the observation of the Assistant Deputy Commissioner and the undersigned.

/s/ E. J. McLARNEY,
Deputy Commissioner.

Mr. Raum: If the Court please, I believe that was all that remained to be done except for fixing of dates for filing of briefs.

The Court: I wish at this time to compliment counsel—and it can be conveyed to counsel for the petitioner inasmuch as it applies equally to both—for the manner in which they have struggled with this case and have presented it. It has reduced extensive trial time to a very short compass and is a very satisfactory presentation.

Mr. Raum: Thank you, your Honor. I am sure Mr. Horrow and I appreciate your remarks.

The Court: How much time do you wish for briefs?

Mr. Raum: In view of the complexity of the cases, [116] your Honor, I believe Mr. Horrow and I felt that 60 days for main briefs and 45 days for replies.

The Court: Do you suggest concurrent or alternative briefs?

Mr. Raum: I didn't discuss that at all with him, sir, and frankly I haven't given consideration to it myself.

The Court: Simultaneous briefs 60 days from this date and 30 days thereafter for reply briefs. Will that be satisfactory?

Mr. Raum: I think it will, sir. The only variation to that is from the dates counsel and myself talked about among ourselves. We suggested 45 days for reply. But I don't know that that will make much difference.

The Court: Forty-five will be allowed. That is perfectly agreeable to the Court.

Mr. Raum: Thank you, your Honor.

The Court: That concludes the submission of the case.

(Thereupon, at 11:30 o'clock a.m., the hearing was concluded.)

[Endorsed]: T.C.U.S. Filed Feb. 24, 1947. [117]

10 T. C. No. 79

The Tax Court of the United States

Basalt Rock Co., Inc., Petitioner, vs. Commissioner of Internal Revenue, Respondent.

Docket No. 10620

Promulgated April 14, 1948

Where a corporation, which regularly computed income from long-term contracts on the completed contract method of accounting and filed its income tax returns accordingly, exercises the election under section 736(b), Internal Revenue Code, to compute its income from long-term contracts for purposes of Chapter 2-E on the percentage of completion method of accounting, Held, that its "corporation surtax net income, computed under section 15" for the purpose of section 710(a)(1)(B) is to be computed upon the percentage of completion method of accounting.

Harry R. Horrow, Esq., for the petitioner.

Leonard Raum, Esq., for the respondent.

OPINION

Disney, Judge: The respondent determined a deficiency of $583,003.64 in the petitioner's excess profits tax liability for the year 1942. The petitioner claims an overpayment of excess profits tax in the sum of $935,575.38. [186]

Several issues were raised in the pleadings but all were settled by stipulation, excepting one, viz.: Whether for purposes of the so-called 80 per cent

limitation provided in section 710(a)(1)(B) of the Internal Revenue Code, the petitioner's surtax net income should be computed according to the percentage of completion method or on the completed contract method, the petitioner having kept its accounts and filed its income and declared value excess profits tax returns for 1942 as to long-term contracts, on the completed contract method, and having exercised the right of election granted by section 736(b), Internal Revenue Code, to report income from long-term contracts on the percentage of completion method.

The stipulated facts are adopted as our findings of fact. In so far as necessary to understand the issue, they are as follows:

The petitioner is a corporation duly incorporated and existing under the laws of the State of California, and engaged in the business of shipbuilding and manufacturing concrete aggregates, road and fuel oils, and building materials. The petitioner files its Federal income and excess profits tax returns on the calendar year basis. Its Federal corporation income and declared value excess-profits tax returns, Form 1120, and its Federal excess profits tax return, Form 1121, for the calendar year 1942 were each filed with the Collector of Internal Revenue for the first district of California.

During the year 1942, and prior and subsequent thereto, the petitioner entered into certain contracts, the performance of each of which required more than twelve months. Such contracts will here-

inafter be termed "long-term contracts." The method of accounting regularly employed by the petitioner in keeping its books of account and in filing its Federal corporation income and declared value excess-profits tax returns was the accrual method, except that [187] with respect to the long-term contracts the method of accounting regularly employed by the petitioner in keeping its books of account and in filing its Federal corporation income and declared value excess profits tax returns was the completed contract method as permitted by section 29.42-4(b) of Regulations 111 and corresponding provisions of prior Regulations. The petitioner filed its Federal corporation income and declared value excess profits tax return for the year 1942 in accordance with such methods of accounting.

At or prior to the time of filing its Federal excess profits tax return, Form 1121, for the year 1942, the petitioner exercised the election provided in section 736(b) of the Internal Revenue Code, to compute its income from long-term contracts upon the percentage of completion method of accounting.

For the year 1942 the petitioner realized income from certain long-term contracts and sustained losses from other long-term contracts, determined on the percentage of completion method of accounting, resulting in a net income for the year 1942 from all of the petitioner's long-term contracts, determined on such method of accounting, in the amount of $409,538.97.

The petitioner sustained losses for the year 1942

from long-term contracts, determined on the completed contract method of accounting, in the amount of $889,898.02.

The petitioner's corporation surtax net income for the year 1942, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, exclusive of any income or loss from long-term contracts and computed without regard to the credit provided in section 26(e) of the Internal Revenue Code, was $1,710,984.13 which, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, is to be adjusted to reflect the proper amount of income or loss for the year 1942 from long-term contracts. [188]

If the petitioner's corporation surtax net income for the year 1942, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, is to be determined by computing income or loss from long-term contracts on the percentage of completion method of accounting, the corporation surtax net income for such purposes, computed without regard to the credit provided in section 26(e) of the Internal Revenue Code, is $2,120,523.10.

If the petitioner's corporation surtax net income for the year 1942, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, is to be determined by computing income or loss from long-term contracts on the completed contract method of accounting, the corporation surtax net income for such purposes, computed without regard to the credit provided in section 26(e) of the Internal Revenue Code, is $821.086.11.

The petitioner's normal tax net income for the year 1942, for purposes of determining the petitioner's normal tax for the year 1942 imposed by Chapter 1 of the Internal Revenue Code, and the petitioner's corporation surtax net income for the year 1942, for purposes of determining petitioner's surtax for the year 1942 imposed by Chapter 1 of the Internal Revenue Code, each computed without regard to the credit provided in section 26(e) of the Internal Revenue Code, were each $821,086.11.

The petitioner's adjusted excess profits net income for the year 1942, determined by computing income or loss from long-term contracts on the percentage of completion method of accounting, was $1,845,468.76. [189]

The parties have stipulated that, if petitioner has an adjusted excess profits net income, determined by computing income or loss from long-term contracts on the completed contract method of accounting, such adjusted excess profits net income so determined is $546,031.77.

There was no increase attributable to contracts completed in 1942 in the petitioner's excess profits tax imposed for either 1940 or 1941 due to its exercise of the election provided in section 736(b) of the Internal Revenue Code.

In its excess profits tax return for 1942, the petitioner showed an excess profits tax of $1,520,-789.06. The petitioner claimed the right to defer payment of $251,790.53 under the provisions of section 710(a)(5) of the [190] Internal Revenue Code, and payment of such $251,790.53 was so de-

ferred. In the excess profits tax return for 1942, the petitioner accordingly showed an excess profits tax payable of $1,268,998.53.

The petitioner's credit for income subject to the excess profits tax, provided in section 26(e) of the Internal Revenue Code, which is allowable for the year 1942, is $546,031.77.

Petitioner's corporation surtax net income, computed without regard to the credit provided in section 26(e) of the Internal Revenue Code for the taxable year ended December 31, 1942, for purposes of section 710(a)(1)(B) of the Internal Revenue Code, is $2,120,523.10.

To recapitulate the facts briefly: In keeping its books of account and in filing its Federal income tax returns, the petitioner regularly employed, with respect to long-term contracts, the completed contract method of accounting. Its 1942 corporation income and declared value excess profits tax return was filed in accordance with such regular method of accounting. In its 1942 excess profits tax return petitioner exercised its right of election under section 736(b), Internal Revenue Code,[1] to report

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[1] Sec. 736. Relief for Installment Basis Taxpayers and Taxpayers With Income From Long-term Contracts.

(b) Election on Long-Term Contracts—In the case of any taxpayer computing income from contracts the performance of which requires more than 12 months, if it is abnormal for the taxpayer to derive income of such class, or, if the taxpayer normally derives income of such class but the amount of such income of such class includible in the gross income of the taxable year is in excess

income from long-term contracts on the percentage of completion method of accounting. [191]

There is no dispute as to the facts. All were stipulated. Nor is there any dispute that petitioner met the eligibility requirements and that it made an

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of 125 per centum of the average amount of the gross income of the same class for the four previous taxable years, or, if the taxpayer was not in existence for four previous taxable years, the taxable years during which the taxpayer was in existence, it may elect, in its return for such taxable year for the purposes of this subchapter [Subchapter E—Excess Profits Tax], or in the case of a taxable year the return for which was filed prior to the date of the enactment of the Revenue Act of 1942, within 6 months after the date of the enactment of such Act, to compute, in accordance with regulations prescribed by the Commissioner with the approval of the Secretary, such income upon the percentage of completion method of accounting. Such election shall be made in accordance with such regulations and shall be irrevocable when once made and shall apply to all other contracts, past, present, or future, the performance of which required or requires more than 12 months. The net income of the taxpayer for each year prior to that with respect to which the election is made shall be adjusted for the purposes of this subchapter including the computation of excess profits net income in each taxable year of the base period under section 711(b), to conform to such election but for the purposes of chapter 1, the tax imposed by this subchapter for any prior taxable year on account of the adjustment required by this subsection shall be considered a part of the tax imposed by this subchapter for the taxable year in which such income is, without regard to this subsection, includible in gross income. Income described in this subsection shall not be considered abnormal income under section 721.

effective election as provided in section 736(b). There is likewise no question as to the computation of the amount of the excess profits tax under section 710(a)(1)(A), Internal Revenue Code,[2] or as to the amount of normal tax and surtax under Chapter 1 for the year 1942, or as to the amount of the [192] credit under section 26(e) to which petitioner is entitled. The only amount in dispute is the amount of "the corporation surtax net income, computed under section 15" within the meaning of section 711(a)(1)(B), Internal Revenue Code,[2] i. e., whether the amount of petitioner's surtax net income for purposes of the so-called 80 per cent limitation provided in section 710(a)(1)(B) is $821,086.11, computed on the completed contract method of accounting, as contended by petitioner, or $2,120,523.10, computed on the percentage of comple-

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[2] Sec. 710. Imposition of Tax.

(a) Imposition.

1. General Rule—There shall be levied, collected, and paid, for each taxable year, upon the adjusted excess profits net income, as defined in subsection (b), of every corporation (except a corporation exempt under section 727) a tax equal to whichever of the following amounts is the lesser:

(A) 90 per centum of the adjusted excess profits net income, or

(B) an amount which when added to the tax imposed for the taxable year under Chapter 1 (other than section 102) equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26(e) (relating to income subject to the tax imposed by this subchapter).

[2] See footnote 2, p. 6.

tion method of accounting, as contended by respondent.

The respondent contends that his position represents the correct interpretation of the statute and is in accord with the applicable regulations. See Regulations 112, section 35.736(b)-3, as amended by T.D. 5388, July 7, 1944 (1944 C.B. 387, 396), and in particular that part which is as follows:

> The excess profits tax may be computed under section 710(a)(1)(B) as an amount which when added to the normal tax and surtax computed under Chapter 1 for the taxable year equals 80 percent of the corporation surtax net income properly adjusted under the provisions of section 710(a)(1)(B) applicable to such year.[3] For such purpose, the corporation surtax net income shall be determined by computing the income from long-term contracts upon the percentage of completion method of accounting. The credit for dividends received used in computing corporation surtax net income [193] shall be limited to 85 percent of the net income determined by computing income from long-term contracts upon the per-

[3] Prior to the amendment by T.D. 5388 the first sentence of quoted portion of Sec. 35.736(b)-3 reads as follows:

The excess profits tax may be computed under section 710(a)(1)(B) as an amount which when added to the normal tax and surtax computed under Chapter 1 equals 80 percent of the corporation surtax net income computed without regard to the credit under section 26(e) (relating to income subject to excess profits tax).

centage of completion method of accounting, and the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1. [Emphasis supplied.]

It is argued by petitioner that the term "the corporation surtax net income" denotes a specific concept and for any year can only be the precise amount arrived at under section 15 of Chapter 1, Internal Revenue Code; that section 710(a)(1)(B) in no way suggests a new concept of corporation surtax net income, but on the contrary that Congress by the use of the term "the corporation surtax net income" amplified by the phrase "computed under section 15" and the reference to "Chapter 1", indicated clearly that the 80 per cent limitation was to be based on the actual corporation surtax net income on which the corporation's surtax liability is imposed; that the only adjustment to corporation surtax net income permissible under section 710(a)(1)(B) is the elimination of the credit under section 26(e) relating to income subject to the excess profits tax; that section 710 (a)(1)(B) was intended to provide an alternative measure of the excess profits tax independent of the measure of such tax under section 710(a)(1) (A); that instead of the 80 per cent limitation in terms of the actual corporation surtax net income, freed of any excess profits tax implications, as Congress intended, the Commissioner requires a reconstruction of the corporation surtax net income based on computations intended to apply only in the determination of adjusted excess profits net

income; and that section 35.736(b)-3 of Regulations 112 is invalid in so far as it provides that when a taxpayer exercises the election under section 736(b), the corporation surtax net income for the purposes of section 710(a)(1)(B) shall be determined by computing the income from long-term contracts on the percentage of completion method of accounting. [194]

Section 15(a) of the Internal Revenue Code provides that "For the purposes of this chapter, the term 'corporation surtax net income' means the net income" minus certain prescribed credits, including the section 26(e) credit.[4] Section 21 defines "net income" as "gross income computed under section 22 less the deductions allowed by section 23." Section 41 provides as a "General Rule" that "net income shall be computed * * * in accordance

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[4] Sec. 15. Surtax on Corporations.

(a) Corporation Surtax Net Income—For the purposes of this chapter, the term "corporation surtax net income" means the net income minus the credit for income subject to the tax imposed by Subchapter E of Chapter 2 provided in section 26 (e) and minus the credit for dividends received provided in section 26(b) (computed by limiting such credit to 85 per centum of the net income reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2 in lieu of 85 per centum of the adjusted net income so reduced, and minus, in the case of a public utility, the credit for dividends paid on its preferred stock provided in section 26(h). For the purposes of this subsection dividends received on the preferred stock of a public utility shall be disregarded in computing the credit for dividends received provided in section 26(b).

with the method of accounting regularly employed in keeping the books of such taxpayer." But obviously such a general rule is not necessarily applicable to special statute-created situations, and this is not a general situation coming under section 41 (which is in Chapter 1), but a specific situation, under a different chapter, and involving a special and different tax and the manner of its computation. Moreover, the petitioner's true earnings are reflected by the percentage of completion basis of accounting. That was the desire of the petitioner in electing that method.

Section 710, Internal Revenue Code, imposes an excess profits tax of either 90 per cent of adjusted excess profits net income, or the difference [195] between the Chapter 1 tax and 80 per cent of "corporation surtax net income, computed under section 15." The crucial question here is as to the meaning in Section 710(a)(1) of the phrase "corporation surtax net income, computed under section 15." For the petitioner contends that the expression "corporation surtax net income, computed under section 15" is a definite statutory Chapter 1 concept, so that, it is argued, the petitioner must compute the 80 per cent "limitation" by using the completed contract method of accounting which it had used in computing its income tax under Chapter 1.

In our opinion such view is in error. In the first place it is contrary to the regulation which requires the petitioner to use the percentage of completion method of accounting, because of the election under

section 736(b) to use that method "for the purposes of this subchapter," i. e., Subchapter E, of Chapter 2, the Excess Profits Tax Law. Section 736(b) specially provides that the petitioner may elect to compute its income "in accordance with regulations prescribed by the Commissioner" upon the percentage of completion method; also, that the election shall be made in accordance with such regulations. The reason Congress so provided and twice left the matter to regulation obviously lay in the complexity of the excess profits statute, its interlocking with the income tax law, and the irrevocability of the election. Under such circumstances we should find, before declaring the regulation invalid, a very clear and positive invasion of the legislative power. Unless the regulation is invalid, the respondent must prevail. The regulation is not to be so held "unless unreasonable or inconsistent with the statute." Fawcus Machine Co. v. United States, 282 U. S. 375; and only for weighty reasons. Brewster v. Gage, 280 U. S. 327; Commissioner v. South Texas Lumber Co.,.. ... U. S..... (March 29, 1944). Yet we find no reason for holding it to be invalid, and find it reasonable and consistent with the [196] statute. There is clear consistency in requiring the petitioner to use the method of accounting which it had elected to use "for the purposes of this subchapter," that is, for excess profits tax purposes, in computing the imposition of such tax, in section 710. Indeed, the matter passes the point of consistency. The only reasonable interpretation of the statute, in our

view, requires the use of the basis elected, for every purpose of Subchapter E of Chapter 2, therefore, requires its use in the computation and "limitation" so-called in section 710(a)(1)(B). The petitioner agrees that the elected method is applicable to section 710(a)(1)(A)—the 90 per cent tax. Is it reasonable then to contend, contrary to the regulation, as petitioner does, that the elected method is inapplicable to the next subsection—which is just as integral a part of the excess profits subchapter as is subsection (A)? To say that the regulation is unreasonable or inconsistent with statute in requiring application of the elected method to both subsections seems to us impossible. On the contrary it seems affirmatively provided by the text which applies the elected method to the entire subchapter dealing with the excess profits tax. We think any other interpretation than expressed in the regulation would be not only inconsistent with the statute, but in the face of its language and purpose. If there was more reason for questioning the interpretation, than we find demonstrated by the petitioner, we should still uphold the regulation, unless it is clearly shown to be contrary to or outside the statute; clearly we think, that showing is noticeably absent.

The effort to eliminate the regulations depends wholly on the words "corporation surtax net income, computed under section 15" in section 710 (a)(1)(B). That language does not clearly, or even inferentially, prohibit computing corporation surtax net income by beginning with income upon a

[197] percentage of completion basis as required by the regulation and as for excess profits tax purposes the taxpayer had elected to do. It would appear to require very plain language to dictate that an excess profits tax under Chapter 2, be imposed by being limited to a percentage of Chapter 1 income. Such plain language to the effect sought by the petitioner—invalidity of the regulation, we cannot find in the above phrase.

Both the statute and decided cases indicate that the elected method of accounting be consistently applied in dealing with excess profits taxes. Section 710(b) requires that once the percentage of computation method is elected, the taxpayer's net income for the base period years shall for excess profits tax purposes be adjusted to conform to the election. [Yet the taxpayer wishes to leave unadjusted, for such purpose, the "corporation surtax net income" for the taxable years itself and to let it be computed though for excess profits tax purposes, on the original completed contract method of accounting.] And in several cases we and Circuit Courts have insisted upon consistence. In Mackin Corporation, 7 T. C. 648; 164 Fed. (2d) 527, the taxpayer, reporting for income tax purposes on the installment basis elected under section 736(a) to compute for excess profits tax purposes on the accrual basis. The effect of the decision is that the accrual basis having been elected, was controlling for excess profits tax purposes, and that a regulation denying deduction of certain bad debts accrued, was invalid for excess profits tax purposes.

In short, the accrual basis having been elected, carried through. Thus it is seen that we denied validity to a regulation (Regulation 109, section 30.736 (a)(3 as amended by T.D. 5257), which called for inconsistency in application of the elected method under section 736(a), which is companion and cosubsection 736(b) here involved and is in [198] nowise different in principle [section 736(a) merely having to do with excess profits on elected accrual method instead of installment method, paralleling the completed contract method and percentage of completion method under section 736(b).] The petitioner, however, here would have us now hold that a regulation requiring consistency in carrying through the use of the elected method, is invalid. In The Hecht Co., 7 T. C. 643; affd., 163 Fed. (2d) 194, the point was the same and the conclusion the same, as in Mackin Corporation, supra.

Again, in Kimbrell's Home Furnishings, Inc., v. Commissioner, 159 Fed. (2d) 608, reversing 7 T. C. 339, we see that the election is for all purposes of excess profits tax; for there the company, formerly computing under the installment basis, elected under section 736(a) to use the accrual basis; and it was held that in figuring invested capital, that is, figuring the amount of accrued earnings and profits under section 718(a)(4), the company was permitted to compute such income on profits (from collections) upon the accrual basis. [The court said: "Since the excess profits tax must be computed by determining the excess profits net income and deducting therefrom the excess profits

tax credit, it would seem logical that the method used in determining one should be consistent with the method used in determining the other."] There the respondent had contended much as the petitioner does here, that the earnings should be figured, like the ordinary income, upon the installment basis. [199]

Commissioner v. South Texas Lumber Co., supra, requires our conclusion above; for there a taxpayer, though using an accrual method, elected under section 44(b), Internal Revenue Code, to report profits from installment sales on the installment method, and was required by Regulations 111, Sec. 29.115-3, to use the elected method in computing earnings and profits. The Court upheld the Regulation and held that the taxpayer was required to use the elected installment method in computing earnings and profits in the computation of equity invested capital under section 718(a)(4). Not only did the Court again emphasize the necessity of sustaining Regulations unless "unreasonable and plainly inconsistent with the revenue statutes and * * * except for weighty reasons," citing Fawcus Machine Co. v. United States, supra, but stress that it is "uniformly held" that the elected basis must be followed. The Court also points out that the fact that it is specifically provided by the statute that the installment basis was to be used "Under regulations prescribed by the Commissioner * * *" gives added reason why the Regulation should not be overruled "unless clearly contrary to the will of Congress."

In fact, we have gone further than merely demanding consistency in the use of the elected method in purely excess profits tax cases; for in West End Furniture Co., 6 T. C. 557, where a taxpayer elected under section 736(a) to compute income on the accrual instead of its usual installment basis, we had [200] the question whether in computing income tax, credit for the amount of adjusted excess profits net income under section 26(e) should be computed upon the elected accrual basis or the original installment basis; and we said that the elected accrual basis must be applied in computing that credit. So it is seen that the method elected for excess profits tax purposes must be applied for every excess profits tax purpose, even though it is only in computing the section 26(e) credit in an ordinary income tax case. Nevertheless the petitioner wishes the use of the elected method curtailed within the excess profits tax subchapter; in effect, asks that "for the purposes of this subchapter" in section 736(b) be held not to cover a part of that subchapter, subsection (B) of section 710(a)(1). The illogic is self-apparent.

As above seen, the effort to strike down the regulation requiring consistent use of the elected method of accounting, and to show error by the respondent, depends upon the expression "corporation surtax net income, computed under section 15" in section 710(a)(1)(B), which petitioner contends contains such a specific concept that though it had for all excess profits tax purposes elected to use the percentage of completion method of accounting,

the completed contract method must here be used because section 15 is in Chapter 1, covering income, in computing which the completed contract method had been used. But we notice immediately that section 15 says that "For the purposes of this chapter, the term 'corporation surtax net income' means * * *." Pointedly, then, the concept or meaning is delimited to Chapter 1, or income tax purposes. It is at least a fair inference from, if not plainly though indirectly expressed in, "For the purposes of this chapter, the term 'corporation surtax net income' means", etc., that for purposes of another chapter (such as Subchapter E of Chapter 2) the expression [201] may mean something else. Surely in another chapter and regarding a different tax, a different basis of accounting could be utilized in computing the corporation surtax net income. This alone would seem to preclude the conclusion sought by the petitioner, at least so far as saying that the regulation is invalid. With the meaning of corporation surtax net income as set out in section 15 (the petitioner's center of argument) confined to Chapter 1 purposes, the regulation is discerned to be at least an altogether possible interpretation of the excess profits subchapter provision in section 736(b).

But is it not plain [and to sustain the regulation it would need be only reasonable arguable interpretation] that the above-quoted language from section 15 does not provide that the same method or basis of accounting be used in computing corporation surtax net income for the present excess profits

tax purpose, as was used for income tax purposes? Beyond argument, that statement is not made in words [and the interpretation in the regulations infers otherwise]. Had petitioner's view been that of the Congress, that body could easily have said, in section 710(a)(1)(B), that the 80 per cent limitation used in imposing excess profits tax, was to be based "on corporation surtax net income computed under the same method of accounting used in computing income tax." But instead it simply said "corporation surtax net income computed under section 15." But section 15, analyzed, merely provides that corporation surtax net income means (as we have seen, for the purposes of Chapter 1) net income minus designated credits: and net income stems from income; and section 736(b) permits a taxpayer to elect (irrevocably) to compute its income on the percentage of completion method. Thus it becomes clear that it is income, with which section 15 starts computing corporation surtax net income (and that "such income" under section 736 (b) is computed upon a percentage of completion basis). Is the regulation, then, unreasonable [202] and outside the statute in saying that the computation must be on percentage of completion? Does not the text of the statute, on the contrary, definitely provide for the use of the percentage of completion method when it requires that method to be used in computing the income which must be ascertained in order to even start the computation of corporation surtax net income? For it is to be noted that section 15 provides a mere computation

—of corporation surtax net income—from net income by subtracting certain credits. And it is equally clear that section 710(a)(1)(B) set the 80 per cent "limitation", upon corporation surtax net income, as computed under section 15. But it could have been computed even under section 15 under any one of several bases of accounting—cash, accrual, installment, completed contract, percentage of completion, etc. This demonstrates that the mere phrase "under section 15" does not designate the method of accounting to be used, most particularly when the corporation surtax net income being computed starts with income, which has for the excess profits tax purpose here involved, been voluntarily placed on a percentage of completion basis, and where we are in fact computing the imposition of the excess profits tax. We compute under section 15, but the bookkeeping method is set for us by the election which placed under the percentage of completion method the income with which we started to compute under section 15. In West End Furniture Co., supra, we said, considering the case of a taxpayer which had exercised the election provided in section 736(a), that "It is thus impossible to escape the conclusion that the term 'normal-tax net income' as used in section 711(a) does not, in and of itself, and in every case, mean the normal tax net income used for income tax purposes." Since "normal tax net income" referred to in section 711(a) is only a step in arriving at corporation surtax net income, from income as a start, the case [203] is authority that "income" for income tax

Chapter 1 purposes is not the same, and may be computed on an accounting principle, different from that used in computing the excess profits tax, so that, in so computing, income and therefore corporation surtax net income, may, under the election, be computed on the percentage of completion basis, though for Chapter 1 purposes income and corporation surtax net income had been computed on the completed contracted method; and "corporation surtax net income" is seen to be no such specific concept as to demand in Subchapter E of Chapter 2 the use of the same accounting basis used in Chapter 1—to say nothing of the above-noted limitation of the phrase in section 15, to Chapter 1 by the text of section 15.

Moreover, the petitioner's view rejects the use of elected basis income, because of a theory that section 15 (though it does not so state) requires use of ordinary Chapter 1 net income and rejection of use of elected basis income; when, in fact, careful examination of section 15 reveals that it actually requires use of the elected basis of income, that is, in the words of section 710(a)(1)(B), in truth requires that "corporation surtax net income, computed under section 15" be computed by use of the elected basis. For section 15 computes corporation surtax net income as net income, minus certain credits, the principal one being for dividends received; but it immediately limits that credit to 85 per cent of net income "reduced by the credit for income subject to the tax imposed by Subchapter E of Chapter 2." So it is seen that

"surtax net income, computed under section 15" can not be computed without taking into consideration, and reducing dividends paid credit by, adjusted excess profits net income under Subchapter E. The petitioner agrees that adjusted excess profits net income is computed under the elected basis of accounting. Nevertheless, it eliminates that basis from [204] section 15, though such basis is therein specifically utilized. It would appear remarkable and inconsistent to compute, in section 15, in part on one method and in part on another. We think that one method, the one elected, and actually used in computing the credit deducted in the computation in section 15, should be used throughout that section.

After much examination of this novel question, we come to the conclusion and hold that Regulations 112, section 35.736(b)-3 as amended by T. D. 5388 is not invalid; and that the use of the elected percentage of completion method of accounting is not confined to subsection (A) of section 710(a) (1) but must be applied, in subsection (B), in imposing the excess profits tax in computing for excess profits tax purposes corporation surtax net income computed under section 15, and that the Commissioner did not err in so computing.

Reviewed by the Court.

Decision will be entered under Rule 50. [205]

Van Fossan, J., dissenting: It will at once be conceded that the instant case poses a difficult question and involves an intricate relationship of pertinent statutes. I cannot avoid the feeling however,

that the prevailing opinion has made a hard problem harder and has added to the difficulty presented by the application of the statutes in question. Fortunately, there is no dispute as to the facts. All were stipulated. The posture of the parties with respect to the controversy is accurately stated in the majority opinion.

The respondent relies on his regulation, which provides (I believe contrary to the statute) "for such purpose, the corporation surtax net income shall be determined by computing the income from long term contracts upon the percentage of completion method of accounting."

The petitioner inveighs against the mandate of the regulation and contends that there is no basis in law for requiring a recomputation of the corporation surtax net income as dictated by the regulation.

It is my judgment that petitioner is amply fortified in his contention that the term "corporation surtax net income" denotes a specific concept which for any year can be only the precise amount arrived at under section 15 of Chapter 1, I.R.C., and that section 710(a)(1)(B) in no way suggests a new concept of corporation surtax net income. On the contrary, Congress, by the use of the term "the corporation surtax net income" amplified by the phrase "computed under section 15" and the reference to "Chapter 1" indicated clearly that the 80 per cent limitation was to be [206] based on the actual corporation surtax net income on which the corporation's surtax liability is imposed. In my

judgment, section 710(a)(1)(B) was calculated to provide an alternative measure of the excess profits tax independent of the measure of such tax under section 710(a)(1)(A).

The majority correctly state that section 15(a), I.R.C., defines "corporation surtax net income" as "the net income" minus certain prescribed credits, including the section 26(e) credit; that section 21 defines "net income" as "the gross income computed under section 22 less the deductions allowed by section 23", and that section 41 provides that generally "net income shall be computed * * * in accordance with the method of accounting regularly employed in keeping the books of such taxpayer." These considerations are basic in the law. Thus "corporation surtax net income" as defined in the statutes is gross income computed under section 22 less the deductions allowed by section 23, minus certain credits enumerated in section 15(a) and all computed in accordance with the method of accounting regularly employed by the taxpayer in keeping its books. It seems to me perfectly clear that Chapter 1 establishes a specific concept of corporation surtax net income and that this concept obtained in the present situation.

At this point the majority falls into inconsistency when it says that the general rules does not govern the present situation. They lean heavily on the regulation as authority, as though the regulation is sacrosanct. As a matter of fact, the whole question before us (and within our jurisdiction to decide) is the validity of the regulation. I do not agree

that "the reason Congress so provided and twice left the matter to regulation [207] obviously lay in the complexity of the excess profits statute, its interlocking with the income tax law and the irrevocability of the election." Although the statute nowhere suggests, and to my mind clearly dictates the contrary, the majority concludes that "the only reasonable interpretation of the statute * * * requires the use of the basis elected for every purpose of Subchapter E of Chapter 2 * * *." They thus write out the statute the provision "corporation surtax net income, computed under section 15" saying that this "language does not clearly or even inferentially, prohibit computing corporation surtax net income by beginning with income upon a percentage of completion basis as required by the regulation * * *." I cannot agree with such a negative approach to the question. The last quoted statement of the majority assumes the conclusion it seeks and clearly violates the statute.

The statement by the majority that "the petitioner's true earnings are reflected by the percentage of completion basis of accounting" is plainly erroneous. Its true earnings are those reflected in its income tax return and for that purpose its method of accounting with respect to long term contracts was the completed contract method. It was not the desire of taxpayer and it made no election to change that method of accounting in so far as computing its "true earnings" was concerned. Its election was made only with reference to the excess profits net income. The true earnings of any

taxpayer are reflected by computation thereof under the method of accounting regularly employed by it.

The stipulated amount contended to be applicable by petitioner reflects the income from long term contracts computed on the completed contract [208] method of accounting, the method regularly employed by petitioner in keeping its books. Petitioner was required to use such method in arriving at its corporation surtax net income under section 15(a) for the imposition of the surtax under section 15(b). In fact, from the statement attached to the notice of deficiency, it appears that the Commissioner used the net income computed on the completed contract method of accounting in determining petitioner's 1942 surtax. Section 710(a)(1)(B) does not purport to change the concept of corporation surtax net income established by Chapter 1, nor does it require a computation of corporation surtax net income different from that required by Chapter 1. In so far as applicable here, it permits only one adjustment to "the corporation surtax net income, computed under section 15", i. e., the elimination therefrom of the credit under section 26(e).

The respondent concedes that neither section 710(a)(1)(B) nor any other provision of the statutes specifically states that the election under section 736(b) is applicable to the determination of corporation surtax net income. Had it been so intended it could easily have been so stated.

The "tax imposed for the taxable year under

Chapter 1" is likewise a factor under section 710 (a)(1)(B) in determining the amount of the excess profits tax. The income tax and surtax imposed under Chapter 1 are also based upon income. Section 29.21-1, Regulation 111, states "The tax imposed by Chapter 1 is upon income." If section 736(b) requires all factors necessary to determine the amount of the excess profits tax which are based upon income to be computed on the percentage of completion method of accounting, that requirement would logically extend to the computation, [209] on the same method of accounting, of the income upon which the income tax and surtax under Chapter 1 are based. Moreover, section 35.-736(b)-3, Regulations 112, provides that in computing the excess profits tax under section 710(a)(1)(B) "the normal tax and surtax shall be the actual normal tax and surtax determined under Chapter 1", which means that the income upon which such taxes are based must be computed upon the completed contract method of accounting and not upon the percentage of completion method of accounting.

In my opinion, the election under section 736(b) is applicable to the determination of excess profits net income for the purposes of section 710(a)(1)(A) only and not to the determination of "corporation surtax net income." It is so stated in section 35.736(b)-2(c).

It is significant that Chapter 1 provides for the computation and determination of corporation surtax net income, whereas Subchapter E of Chapter 2, which includes section 736(b), provides for the

computation and determination of adjusted excess profits net income. Section 710(a)(1), although included in Subchapter E of Chapter 2, does not pertain to the computation of income of any kind but merely provides two measures for the excess profits tax, the one being the adjusted excess profits net income and the other the corporation surtax net income without regard to the credit relating to the income subject to the excess profits tax less the tax imposed by Chapter 1.

Without laboring the question further, it is my conclusion that section 35.736 of Regulations 112 as amended by T. D. 5388, is invalid in so far as it requires that for the purpose of section 710(a)(1)(B) "the [210] corporation surtax net income shall be determined by computing the income from long term contracts upon the percentage of completion method of accounting." I therefore dissent.

Arundell, Black, and Johnson, JJ., agree with this dissent. [211]

Kern, J., dissenting: Since I am convinced that the result reached by the majority and the respondent's regulation upon the question presented by this case are in conflict with the pertinent statutory provisions, I must respectfully note my dissent.

Section 710(a) of Chapter 2 of the Internal Revenue Code imposes a tax upon the adjusted excess profits net income of every corporation. This tax may be computed either under 710(a)(1)(A) or 710(a)(1)(B), dependent upon which produces the lesser tax. If the tax is computed under sec-

tion 710(a)(1)(A) it will be "90 percentum of the adjusted excess profits net income", and in making the computations prerequisite to an ascertainment of what is the corporation's excess profits net income it will be necessary to wind through the maze of novel and complicated concepts introduced into the Internal Revenue Code in 1940 by Subchapter E of Chapter 2. However, if the tax is computed under section 710(a)(1)(B) the taxpayer will be dealing with familiar and comparatively simple concepts which it has already met in computing its corporation surtax under chapter 1.

In computing "Excess Profits Net Income" as that phrase is used in Chapter 2, Subchapter E of the Internal Revenue Code, or the excess profits tax representing a percentage of excess profits net income (Sec. 710(a)(1)(A)), or a credit to be subtracted from net income taxable under Chapter 1, which, by section 26(e) is to be "an amount equal to * * * adjusted excess profits net income", sections 736(a) and (b) are to be applied to all steps requiring the ascertainment [212] and use of "net income" as a factor in the determination of "excess profits net income" under Chapter 2, since otherwise neither a correct nor a realistic figure for "excess profits net income" can be obtained. This would be true of any computations starting with section 710(a)(1)(A). See West End Furniture Co., 6 T. C. 557.

However, section 710(a)(1)(B) does not require a computation of a tax representing a percentage

of excess profits net income. It provides a substitute for a tax thus computed and is written in the familiar terms of Chapter 1. Regardless of the amount of excess profits net income or the tax representing a percentage thereof, if a lesser amount would result from subtracting the amount of the tax imposed by Chapter 1 from an amount equal to 80 percentum of the corporation surtax net income computed under section 15 of Chapter 1, then that lesser amount shall be the excess profits tax. The only way in which section 710(a)(1)(A) affects the computation of the amount of tax under section 710(a)(1)(B) is to assure the taxpayer that it is paying a lesser amount of tax under section 710(a)(1)(B) than it would have paid had its tax been computed under section 710(a)(1)(A). Only to the extent of thus protecting a taxpayer in any calculation of "excess profits net income" necessary in computing excess profits tax under section 710(a)(1)(B).

Regardless of whether the "excess profits net income" of petitioner be computed on the completed contract method or the percentage of completion method, if the 90 per centum thereof is greater than the "amount which when added to the tax imposed * * * under chapter 1 * * * equals 80 per centum of the corporation surtax net income computed under section 15 [213] * * *", then the latter and lesser amount shall be petitioner's excess profits tax.

Only in section 710(a)(1)(B) does the term "corporation surtax net income" appear in Chapter 2,

Subchapter E. In none of the computations necessary under this subchapter to arrive at the "excess profits net income" upon which the excess profits tax is calculated under section 710(a)(1)(A) is this term used. In none of the computations is it pertinent. It is used in the section which provides a substitute for and a limitation on the tax computed by the complicated method starting with section 710(a)(1)(A) and requiring the ascertainment and use of "excess profits net income."

In my opinion section 710(a)(1)(B) in using the words and figures "* * * 80 per centum of the corporation surtax net income, computed under section 15 * * *" means exactly what it says and should not be construed to read "* * * 80 per centum of the corporation surtax net income, computed under section 15 and/or section 736(b) of subchapter E of Chapter 2 * * *."

Arundell and Black, JJ., agree with this dissent.

[214]

[Title of Tax Court and Cause.]

COMPUTATION FOR ENTRY OF DECISION

Comes now the Commissioner of Internal Revenue, respondent above named, by his attorney, Charles Oliphant, Chief Counsel, Bureau of Internal Revenue, and submits the attached computation of the deficiency under the opinion of The Tax Court of the United States promulgated April 14, 1948, 10 T. C. No. 79, in the above-entitled appeal.

The respondent's computation is submitted in accordance with Rule 50 of the Court's Rules of Practice and is without prejudice to his right to contest the correctness of the decision pursuant to the statute in such cases made and provided.

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.

Of Counsel:

B. H. NEBLETT,
Division Counsel;

LEONARD RAUM,
T. M. MATHER,
Special Attorneys,
Bureau of Internal Revenue. [215]

AUDIT STATEMENT

In re: Basalt Rock Co., Ltd., 8th and River Streets, Napa, California

Docket No. 10620

Tax Liability for the Taxable Year Ended December 31, 1942

Liability	Assessed	Deficiency
	Income Tax	
$ 104,379.17	$ 71,829.54	$ 32,549.63
	Excess Profits Tax	
$ 1,592,039.31	$ 1,236,697.10	$355,342.21

Recomputation of tax liability prepared in accordance with the opinion of The Tax Court of the United States promulgated April 14, 1948. [216]

Year 1942

Schedule 1

Income Tax Net Income

Net income as disclosed by deficiency notice dated January 25, 1946	$922,502.21
As adjusted, based on the Opinion of The Tax Court of the United States promulgated April 14, 1948, and Stipulations of Facts between the parties	821,086.11
Adjustment (Decrease)	$101,416.10

Schedule 2

Explanation of Adjustment

Net income is decreased $101,416.10, in accordance with the Stipulations of Facts between the parties holding that petitioner's normal tax net income, before allowance of Section 26(e) credit, was $821,086.11, in lieu of $922,502.21 as shown in the deficiency notice.

Schedule 3

Computation of Tax
Declared Value Excess-Profits Tax

Net income for declared value excess-profits tax computation, Schedule 1	$ 821,086.11
Less: 10% of $17,000,000.00, value of capital stock as declared in your capital stock tax return for the year ended June 30, 1942	1,700,000.00
Balance subject to declared value excess-profits tax	None
Declared value excess-profits tax liability	None
Declared value excess-profits tax assessed: Original, Account No. 410343, June 1943 list, 1st California District	None
Deficiency or overassessment in declared value excess-profits tax	None

Income Tax

Net income for declared value excess-profits tax computation, Schedule 1		$821,086.11
Less: Declared value excess-profits tax		None
Net income for capital stock tax purposes		$821,086.11
Less: Income subject to excess profits tax as per Stipulation of Facts		546,031.77
Normal-tax net income		$275,054.34
Normal Tax Computation:		
Normal-tax net income	$275,054.34	
Tax at 24% on $275,054.34		$ 66,013.04
Surtax Computation:		
Surtax net income	$275,054.34	
Tax at 16% on $275,054.34		44,008.69
Total normal tax and surtax		$110,021.73
Alternative tax, Schedule 4		104,379.17
Income tax liability		$104,379.17
Income tax assessed: Original, Account No. 410343, June 1943 list, 1st California District		71,829.54
Deficiency in income tax		$ 32,549.63

Schedule 4

Computation of Alternative Tax

Net income for declared value excess-profits tax computation, Schedule 1		$821,086.11
Less: Net long-term capital gain	$ 37,617.15	
Declared value excess-profits-tax	None	37,617.15
Adjusted net income		$783,468.96
Less: Income subject to excess profits tax as per Stipulation of Facts		546,031.77
Normal-tax net income		$237,437.19
Normal Tax Computation:		
Normal-tax net income	$237,437.19	
Tax at 24% on $237,437.19		$ 56,984.93

Surtax Computation:		
Surtax net income	$237,437.19	
Tax at 16% on $237,437.19		37,989.95
Partial tax		$ 94,974.88
Add: 25% of net long-term capital gain		9,404.29
Alternative tax		$104,379.17

Schedule 5

Excess Profits Net Income

Net income as disclosed by deficiency notice dated January 25, 1946	$ 2,285,144.69
As adjusted, based on the Opinion of The Tax Court of the United States promulgated April 14, 1948, and Stipulation of Facts between the parties	2,001,096.06
Adjustment (Decrease)	$ 284,048.63

Schedule 6

Explanation of Adjustment

Net income is decreased $284,048.63, in accordance with the Stipulations of Facts between the parties holding that petitioner's excess profits net income was $2,001,096.06, in lieu of $2,285,144.69 as shown in the deficiency notice.

Schedule 7

Computation of Excess Profits Tax

Excess profits net income, Schedule 5		$ 2,001.096.06
Less: Specific exemption	$ 5,000.00	
Excess profits credit as shown in deficiency notice	150,627.30	155,627.30
Adjusted excess profits net income		$ 1,845,468.76
90% thereof		$ 1,660,921.88
*Surtax net income (computed without regard to credit provided by Section 26(e)), as per Stipulation of Facts	$ 2,120,523.10	
80% thereof	$ 1,696,418.48	
Less: Income tax under Chapter I (other than Section 102) for the taxable year	104,379.17	
Balance	$ 1,592,039.31	
Excess profits tax: Above balance, or 90% of adjusted excess profits net income, whichever is the lesser amount		$ 1,592,039.31
Excess profits tax liability		$ 1,592,039.31
Excess profits tax assessed: Original, Account No. 400309, June 1943 list, 1st California District	$ 1,268,998.53	
Less: Overassessment scheduled	32,301.43	1,236,697.10
Deficiency in excess profits tax		$ 355,342.21

* The Opinion of The Tax Court of the United States holds that for the purposes of the 80 percent limitation on excess profits tax under Section 710(a)(1)(B) of the Internal Revenue Code, the petitioner's surtax net income should be computed on the percentage completion basis, rather than on the completed contract basis as held by the petitioner.

Schedule 8

Post-War Refund of Excess Profits Tax Credit for Debt Retirement

	Return	Corrected
Excess profits tax	$ 1,268,998.53	$ 1,592,039.31
Credit allowable under Sections 780 and 781	$ 126,899.85	$ 159,203.93
Net reduction in indebtedness under Section 783	None	
Credit for debt retirement allowable	None	None
Net post-war refund credit	$ 126,899.85	$ 159,203.93

STATEMENT OF ACCOUNT

In re: Basalt Rock Co., Inc., Eighth and River Street, Napa, California

Docket No. 10620

Year: 1942

	Income Tax		Excess Profits Tax
Tax Liability	$104,379.17		$ 1,592,039.31
Tax assessed:			
Original, Account No. 410343, June 1943 list, 1st California District	71,829.54		
Original, Account No. 400309, June 1943 list, 1st California District		$ 1,268,998.53	
Less: Overassessment, Schedule: AM-1452	0.00	32,301.43	1,236,697.10
Deficiency in assessment	$ 32,549.63		$ 355,342.21

		Income Tax		Excess Profits Tax
Tax liability		$104,379.17		$ 1,592,039.31
Tax paid:				
March 15, 1943	$17,957.39		$ 333,042.61	
June 15, 1943	17,957.37		301,456.65	
September 17, 1943	17,957.38		0.00	
December 15 1943	17,957.39		0.00	
March 7, 1944	0.00		634,499.27	
August 11, 1944	.01		0.00	
Total	$71,829.54		$ 1,268,998.53	
Less: Amount credited to 1941 tax on 1945 November 16, 529000 Commissioner's list	0.00		32,301.43	
Net amount paid		$ 71,829.54		$ 1,236,697.10
Deficiency in payment		$ 32,549.63		$ 355,342.21

A Certificate of Assessments and Payments, Form 899, submitted by the Collector of Internal Revenue, San Francisco, California, on May 17, 1948, discloses that the following amounts were paid and are held in the Collector's Suspense Account, pending assessment:

		Amount	
List	Date Paid	Tax	Interest
48-Jan-501127	August 6, 1946	$251,790.53	$50,854.79
48-Jan-501121	August 6, 1946	113,678.51	0.00
	Total	$365,469.04	$50,854.79

Deficiency notice dated January 25, 1946.

[Endorsed]: T.C.U.S. Filed June 9, 1948. [223]

The Tax Court of the United States

Washington

Docket No. 10620

BASALT ROCK CO., INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its opinion promulgated herein on April 14, 1948, providing that decision be entered under Rule 50, the respondent, on June 9, 1948, filed his computation; whereupon the case was, pursuant to notice given to the petitioner, filed for hearing upon such computation on July 7, 1948. Petitioner appeared not and has filed no computation. It is

Ordered and Decided: That there are deficiencies for the taxable year ending December 31, 1942, as follows:

In income tax in the amount of $32,549.63; and in excess profits tax in the amount of $355,342.21.

Entered July 12, 1948.

/s/ R. L. DISNEY,
Judge.

[224]

[Title of Tax Court and Cause.]

MOTION TO VACATE DECISION

Comes now Basalt Rock Co., Inc., the petitioner above named, by its atttorneys Sigvald Nielson and Harry R. Horrow, and moves that the decision entered in the above-entitled proceeding on July 12, 1948, be vacated and that a new decision be entered herein so as to set forth only a deficiency in excess profits tax for the taxable year ended December 31, 1942.

In support of this motion, petitioner shows as follows:

1. The deficiency notice, in respect of which the petition in this proceeding is filed, determined a deficiency in excess profits tax and an overassessment in income tax for the taxable year ended December 31, 1942.

2. Paragraph III of the petition filed herein, which is admitted by respondent's answer, alleges that the tax in controversy is excess profits tax for the taxable year ended December 31, [225] 1942.

3. Since no deficiency in income tax for the year 1942 was determined by respondent or is in controversy herein, the Tax Court has no jurisdiction in this proceeding to determine the income tax liability of petitioner for the year 1942 (Pioneer Parachute Company, Inc., 4 T. C. 27; Liberty Mirror Works, 3 T. C. 1018). The decision entered

herein on July 12, 1948, that there is a deficiency in income tax for the taxable year ended December 31, 1942, is erroneous and should be vacated and a new decision should be entered setting forth only the deficiency in excess profits tax for said taxable year.

4. No objection was made by petitioner to the computation for entry of decision under Rule 50, filed by respondent, by reason of the understanding with counsel for respondent that the Tax Court had jurisdiction only over the excess profits tax of petitioner for the year 1942, and that accordingly the entry of decision pursuant to respondent's computation would cover only a deficiency in excess profits tax for said year.

Wherefore, it is prayed that this motion be granted.

Dated San Francisco, California, Aug. 6, 1948.

/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW.

[Endorsed]: T.C.U.S. Filed Aug. 9, 1948. [226]

[Title of Tax Court and Cause.]

ORDER

Pursuant to the determination of the Court, the respondent, on June 9, 1948, filed its computation, of deficiency of $32,549.63 in income tax and of $355,342.21 in excess profits tax, and the petitioner having filed no computation and the matter coming on for hearing on July 12, 1948, and the petitioner appearing not, decision was entered in accordance with the computation of respondent. The petitioner has now filed its motion to vacate decision on the ground that this Court has no jurisdiction as to income tax, there having been no determination of deficiency therein, but a determination of over-assessment, as shown by the deficiency notice. This Court having no jurisdiction over such over-assessment of income tax, it is. therefore,

Ordered: That the decision entered herein on July 12, 1948, be, and the same is hereby, vacated and set aside.

(Seal) /s/ R. L. DISNEY,
Judge.

Dated Washington, D. C., August 27, 1948 [227]

The Tax Court of the United States

Washington

Docket No. 10620

BASALT ROCK CO., INC.,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION

Pursuant to the determination of the Court, as set forth in its opinion promulgated herein on Apr. 14, 1948, providing that decision be entered under Rule 50, the respondent, on June 9, 1948, filed his computation; whereupon the case was, pursuant to notice given to the petitioner, filed for hearing upon such computation on July 7, 1948. Petitioner appeared not and has filed no computation. It is

Ordered and Decided: That there is a deficiency for the taxable year ending December 31, 1942, in excess profits tax, in the amount of $355,342.21.

Entered August 30, 1948.

(Seal) /s/ R. L. DISNEY,
Judge. [228]

In the United States Court of Appeals
For the Ninth Circuit

T. C. Docket No. 10,620

BASALT ROCK CO., INC.,
Petitioner on Review,
vs.
GEORGE SCHOENEMAN, Commissioner of Internal Revenue,
Respondent on Review.

PETITION FOR REVIEW

To the Honorable Judges of the United States Court of Appeals for the Ninth Circuit:

Now comes Basalt Rock Co., Inc., by and through its attorneys Sigvald Nielson, Esq., and Harry R. Horrow, Esq., and respectfully shows:

I.

Jurisdiction

The petitioner on review, Basalt Rock Co., Inc., hereinafter referred to as the "taxpayer", is a corporation duly organized and existing under the laws of the State of California, with its principal office at Napa, California. The respondent on review, George J. Schoeneman, hereinafter referred to as the [229] "Commissioner", is the duly appointed, qualified and acting Commissioner of Internal Revenue.

The taxpayer's federal excess profits tax return for the calendar year 1942 was filed with the Col-

lector of Internal Revenue for the First District of California, whose office is within the jurisdiction of the United States Court of Appeals for the Ninth Circuit, wherein this review is sought. Your petitioner seeks a review of the decision of the Tax Court of the United States pursuant to the provisions of sections 1141 and 1142 of the Internal Revenue Code as amended.

II.

Prior Proceedings

On January 25, 1946, the Commissioner determined a deficiency in excess profits tax for the calendar year 1942 in the amount of $583,003.64 and sent to the taxpayer by registered mail a notice of said deficiency. Thereafter, on April 22, 1946, and within the time prescribed by law, the taxpayer filed a petition with the Tax Court of the United States seeking a redetermination of said deficiency and alleging that there was no deficiency in excess profits tax due from the taxpayer for the year 1942, but that there was an overpayment in excess profits tax due to petitioner for said year in the sum of $611,004.40. On June 5, 1946, the Commissioner filed his answer to said petition. Subsequent thereto amendments to said petition were filed by the [230] taxpayer and answers to said amendments were filed by the Commissioner. On December 13, 1946, the taxpayer filed a second amendment to the petition alleging that there was an overpayment in excess profits tax due to petitioner for the year 1942 in the sum of $935,575.38.

The answer of the Commissioner to said amendment was filed on December 13, 1946. The case was heard in part before a division of the Tax Court at San Francisco, California, on December 13, 1946, and on motion of counsel for both parties was continued for further hearing in Washington, D. C. Such further hearing was held on February 12, 1947, and on April 14, 1948, the Tax Court promulgated the majority and dissenting opinions. The Tax Court entered its decision on July 12, 1948, ordering and deciding that there is a deficiency in income tax of $32,549.63 and in excess profits tax of $355,342.21. On August 9, 1948, the taxpayer filed its motion to vacate said decision and to enter a new decision relating only to the excess profits tax of taxpayer for the calendar year 1942. On August 30, 1948, the Tax Court vacated said decision and entered its decision ordering and deciding that there is a deficiency in excess profits tax for the calendar year 1942 in the amount of $355,342.21.

III.

Nature of Controversy

Taxpayer is a corporation engaged in shipbuilding and the manufacture of concrete aggregates, road and fuel oils, and [231] building materials. It was regularly engaged in the performance of long-term contracts, that is, contracts the performance of which required more than twelve months. During the year 1942 taxpayer was engaged in the performance of work on six long-term contracts, of which two were completed during said year and

four were completed subsequent thereto. The method of accounting regularly employed by taxpayer in keeping its books of account and in filing its federal income tax returns was the accrual method with respect to sources of income other than long-term contracts, and was with respect to long-term contracts the completed contract method as defined in section 29.42-4(b) of Regulations 111. The taxpayer's federal corporation income and declared value excess profits tax returns for the year 1942 were filed in accordance with said regular methods of accounting.

The taxpayer exercised an election under the excess profits tax provisions of section 736(b) of the Internal Revenue Code to compute income from long-term contracts in its excess profits tax return on the percentage of completion method of accounting. Taxpayer's excess profits tax return for the year 1942 computed income from long-term contracts on the percentage of completion method.

Under the completed contract method of accounting all of the income and all of the deductions attributable to the performance of a long-term contract are reported for the taxable year in which the contract is finally completed and accepted. This method is available to [232] taxpayers under the provisions of the Regulations referred to, provided that method clearly reflects the net income of the taxpayer. On the completed contract basis the taxpayer sustained total net losses on long-term contracts completed during the taxable year 1942 in the amount of $889,898.02. These losses were in-

cluded in its books in accordance with its regular method of accounting and were reported in its corporation income tax return in arriving at its normal tax and surtax liability for the year 1942. Under the percentage of completion method of accounting income and deductions in respect of long-term contracts are reported during the years of performance of such contracts on the basis of the percentage of completion attributable to each year's performance, as shown by certificates of architects or engineers. On the percentage of completion basis the taxpayer realized net income from long-term contracts performed during the year 1942 in the amount of $409,538.97.

The controversy herein relates to the proper construction of section 710(a)(1)(B) of the Internal Revenue Code, which provides an alternative method of computing the excess profits tax. The excess profits tax imposed for the year 1942 is a tax equal to the lesser of:

> "(A) 90 per centum of the adjusted excess profits net income, or
>
> (B) an amount which when added to the tax imposed for the taxable year under Chapter 1 * * * equals 80 per centum of the corporation surtax net income, computed under section 15 or Supplement G, as the case may be, but without regard to the credit provided in section 26(e) * * *" (sec. 710(a)(1)(B)). [233]

The parties are in agreement as to the tax computed under section 710(a)(1)(A), which is equal

to 90 per centum of the adjusted excess profits net income. The parties disagree as to the method of computing the lesser alternative tax under section 710(a)(1)(B). The dispute centers around the interpretation of the language "corporation surtax net income," 80 per centum of which (but without regard to the credit provided in section 26(e)) less the normal taxes and surtaxes imposed under Chapter 1 equals the tax computed under section 710(a)(1)(B).

The parties do not disagree as to the taxes imposed on the taxpayer under Chapter 1, nor as to the amount of section 26(e) credit. The parties stipulated that the taxpayer's corporation surtax net income under section 15, on which its actual surtax liability for the year 1942 was imposed, computed without regard to the section 26(e) credit, was $821,086.11. Said amount was arrived at by computing income from long-term contracts on the regular method of accounting of the taxpayer, the completed contract basis, and reflects the net losses sustained on the long-term contracts completed in the taxable year 1942 in the amount of $889,898.02. The taxpayer's adjusted excess profits net income for the year 1942 was $1,845,468.76. Said amount was arrived at by including net income from long-term contracts on the percentage of completion basis of $409,538.97. The Tax Court found that for the purposes of section 710(a)(1)(B) the corporation surtax net income computed under section 15, without regard to the credit [234] provided by section 26(e), was $2,120,523.10. This

amount equals the corporation surtax net income of $1,710,984.13, without the section 26(e) credit and without income or losses from long-term contracts, plus $409,538.97 of net income from long-term contracts computed on the percentage of completion basis. The taxpayer contends that its excess profits tax for the year 1942 must be computed under section 710(a)(1)(B) by subtracting its normal tax and surtax liability under Chapter 1 from 80 per cent of $821,086.11, the corporation surtax net income under Chapter 1, on which its actual surtax liability was computed (but without regard to the section 26(e) credit), which amount reflects the total net losses of $889,898.02 from long-term contracts computed on the completed contract basis.

A majority of the Tax Court determined and held that the taxpayer's corporation surtax net income under section 710(a)(1)(B) should be determined by computing income from long-term contracts on the percentage of completion basis, the method of accounting elected by the taxpayer under section 736(b). Five judges of the Tax Court dissented in two separate dissenting opinions, holding that the corporation surtax net income referred to in section 710(a)(1)(B) is the corporation surtax net income computed under the same method of accounting, the completed contract method, used in determining taxpayer's actual surtax liability for 1942. [235]

The taxpayer, being aggrieved by the opinion and decision of the Tax Court of the United States

in this proceeding, hereby petitions for a review of said opinion and decision by the United States Court of Appeals for the Ninth Circuit.

IV.

Assignments of Error

Taxpayer alleges that the Tax Court erred in the following respects:

1. The Tax Court erred in failing to hold that the phrase "corporation surtax net income, computed under section 15" in section 710(a)(1)(B) of the Internal Revenue Code refers to the specific corporation surtax net income computed under section 15 of Chapter 1 on which the surtax provided in Chapter 1 is imposed.

2. The Tax Court erred in failing to hold that the so-called 80 per cent limitation prescribed in section 710(a)(1)(B) on the amount of excess profits tax must be determined by using the regular method of accounting applicable in determining the taxpayer's surtax net income under Chapter 1.

3. The Tax Court erred in holding that the percentage of completion method of accounting elected by the taxpayer with respect to its long-term contracts applied in the determination of the taxpayer's corporation surtax net income computed under Chapter 1 for purposes of section 710(a)(1)(B).

4. The Tax Court erred in holding that the taxpayer for the year 1942 had two corporation surtax net incomes computed [236] without regard to section 26(e), one computed under section 15 for the purposes of the surtax under Chapter 1,

and the other computed under section 710(a)(1)(B) for the purposes of the excess profits tax.

5. The Tax Court erred in holding that said election under section 736(b) required the use of the elected method of accounting for every purpose of the excess profits tax.

6. The Tax Court erred in failing to hold that the percentage of completion method of accounting elected applied only to the determination of the excess profits net income on which the excess profits tax is computed under section 710(a)(1)(A).

7. The Tax Court erred in failing to hold that section 710(a)(1)(A) and section 710(a)(1)(B) provide alternative and mutually exclusive methods of computing the taxpayer's excess profits tax liability.

8. The Tax Court erred in failing to hold that section 710(a)(1)(B) prescribes a computation of the excess profits tax wholly divorced from and independent of all other excess profits tax provisions contained in subchapter (e) of Chapter 2.

9. The Tax Court erred in construing section 710(a)(1)(B) as providing for a computation of income instead of a computation of tax.

10. The Tax Court erred in holding that the application of the elected method of accounting in computing the excess profits tax under section 710(a)(1)(B) was required by a rule of [237] consistency.

11. The Tax Court erred in failing to hold that there is no consistency required between section 710(a)(1)(A) and section 710(a)(1)(B), since

these sections are basically inconsistent with each other.

12. The Tax Court erred in failing to hold that all of the factors of computation of tax prescribed in section 710(a)(1)(B) must be computed on a consistent basis, namely, the use of the completed contract method of accounting for long-term contracts.

13. The Tax Court erred in holding that the Commissioner's regulation prescribing the use of the percentage of completion method elected under section 736(b) in determining corporation surtax net income for the purposes of section 710(a)(1)(B) is valid.

14. The Tax Court erred in failing to hold that the taxpayer's excess profits tax for the year 1942 must be computed by subtracting its normal tax and surtax liability from 80 per centum of the amount of $821,086.11.

15. The Tax Court erred in holding that the taxpayer's excess profits tax for the year 1942 should be computed by subtracting its normal tax and its surtax liability from 80 per centum of the amount of $2,120,523.10.

16. The Tax Court erred in ordering and deciding that there is due from the taxpayer for the year 1942 a deficiency in excess profits tax in the amount of $355,342.21. [238]

17. The Tax Court erred in failing to determine and decide that there is due to taxpayer an overpayment of excess profits tax for the year 1942 in the amount of $935,575.38.

Wherefore, taxpayer petitions that said findings of fact, opinion and decision of the Tax Court of the United States be reviewed by the United States Court of Appeals for the Ninth Circuit, that a transcript of the entire record be prepared in accordance with law and the rules of said court and transmitted to the clerk of said court for filing, and that said court take appropriate action to the end that the opinion and decision of the Tax Court of the United States may be reviewed and the errors complained of herein corrected by said court.

Dated, San Francisco, California, Sept. 1, 1948.

/s/ SIGVALD NIELSON,

/s/ HARRY R. HORROW,
Attorneys for Petitioner.

[Endorsed]: T.C.U.S. Filed Sept. 29, 1948. [239]

[Title of U. S. Court of Appeals and Cause.]

NOTICE OF FILING PETITION FOR REVIEW

To George J. Schoeneman, Commissioner of Internal Revenue, Washington, D. C.:

You are hereby notified Basalt Rock Co., Inc., did on the 29th day of September, 1948, file with the clerk of the Tax Court of the United States in Washington, D. C., a petition for review by the United States Court of Appeals for the Ninth Circuit of a decision of the Tax Court heretofore rendered in the above entitled cause. A copy of the petition for review and the assignment of error as filed is hereto attached and served upon you.

Dated, San Francisco, California, Sept. 1, 1948.

/s/ SIGVALD NIELSON,

/s/ HARRY R. HORROW,
Attorneys for Petitioner
on Review. [240]

Personal service of the above and foregoing notice, together with a copy of the petition for review and assignments of error mentioned therein, is hereby acknowledged this 29th day of September, 1948.

/s/ CHARLES OLIPHANT,
Attorney for Respondent on Review.

[Endorsed]: T.C.U.S. Filed Sept. 29, 1948. [241]

[Title of Tax Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Basalt Rock Co., Inc., the petitioner above named, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the decision entered in the above-entitled proceeding on August 30, 1948.

Dated September 1, 1948.

/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
Attorneys for Petitioner.

Personal service of the above and foregoing notice of appeal is hereby acknowledged this 29th day of September, 1948.

/s/ CHARLES OLIPHANT,
Chief Counsel, Bureau of Internal Revenue, Attorney for Respondent.

[Endorsed]: T.C.U.S. Filed Sept. 29, 1948. [242]

[Title of Tax Court and Cause.]

DESIGNATION OF CONTENTS OF RECORD ON REVIEW

To the Clerk of the Tax Court of the United States:

You will please prepare and deliver to the Clerk of the United States Court of Appeals for the Ninth Circuit copies duly certified as correct of the entire record in the above-entitled cause, in connec-

tion with the petition for review heretofore filed by Basalt Rock Co., Inc., including the following documents and records:

1. Docket entries of all proceedings before the Tax Court;
2. All pleadings before the Tax Court, including the following:
(a) Petition, including Exhibit A attached thereto;
(b) Request for place of hearing;
(c) Answer; [243]
(d) Motion for leave to file amendments to petition;
(e) Amendments to petition;
(f) Answer to amendments to petition;
(g) Motion for leave to file second amendments to petition;
(h) Second amendments to petition;
(i) Answer to second amendments to petition;
3. Stipulation of facts;
4. Order of continuance;
5. Supplemental stipulation of facts;
6. Entire transcript of hearings December 13, 1946, at San Francisco, California, and February 12, 1947, in Washington, D. C.;
7. All of the exhibits in said cause, being:

Petitioner's Exhibit 1. United States corporation income and declared value excess profits tax return for calendar year 1942 filed by Basalt Rock Company, Inc.

Petitioner's Exhibit 2. United States corpora-

tion excess profits tax return for calendar year 1942 filed by Basalt Rock Company, Inc.

Petitioner's Exhibit 3. Claim for refund by Basalt Rock Company, Inc., for $530,996.76, overpayment on account of excess profits tax paid for period from January 1, 1942, to December 31, 1942.

Petitioner's Exhibit 4. Original opinion of the Tax Court of the United States in West End Furniture [244] Company v. Commissioner of Internal Revenue, Docket No. 5688.

Petitioner's Exhibit 5. Motion for leave to file motion for deletion of certain portions of opinion in West End Furniture Company v. Commissioner of Internal Revenue, Docket No. 5688, in the Tax Court of the United States;

Motion for deletion of certain portions of the court's opinion promulgated March 22, 1946, in West End Furniture Company v. Commissioner of Internal Revenue;

Order of the Tax Court of the United States dated August 7, 1946, granting motion for deletion of certain portions of Court's opinion promulgated March 22, 1946, in West End Furniture Company v. Commissioner of Internal Revenue.

Petitioner's Exhibit 6. Letter dated December 4, 1946, from Colin F. Stam, Chairman of Joint Committee on Internal Revenue Taxation, to Harry R. Horrow.

Respondent's Exhibit A. Memorandum for Chief Counsel, Bureau of Internal Revenue, from Deputy Commissioner E. I. McLarney.

8. Majority opinion of the Tax Court, dissenting opinion of Judges Van Fossan, Arundell, Black and Johnson, and dissenting opinion of Judges Kern, Arundell and Black; [245]

9. Respondent's computation for entry of decision;

10. Decision of the Tax Court;

11. Motion of petitioner to vacate decision;

12. Order vacating decision;

13. New decision;

14. Petition for review;

15. Notice of filing petition for review;

16. Notice of Appeal;

17. This designation of contents of record on review.

/s/ SIGVALD NIELSON,

/s/ HARRY R. HORROW,
Attorneys for Petitioner.

(Service acknowledged 9/29/48.)

/s/ CHARLES OLIPHANT,
Chief Counsel,
Bureau of Internal Revenue.

[Endorsed]: T.C.U.S. Filed Sept. 29, 1948. [246]

[Title of Tax Court and Cause.]

CERTIFICATE

I, Victor S. Mersch, clerk of The Tax Court of the United States do hereby certify that the foregoing pages, 1 to 246, inclusive, contain and are a true copy of the transcript of record, papers, and proceedings on file and of record in my office as called for by the Praecipe in the appeal (or appeals) as above numbered and entitled.

In testimony whereof, I hereunto set my hand and affix the seal of The Tax Court of the United States, at Washington, in the District of Columbia, this 21st day of October, 1948.

(Seal) /s/ VICTOR S. MERSCH,
Clerk, The Tax Court of the United States.

[Endorsed]: No. 12080. United States Court of Appeals for the Ninth Circuit. Basalt Rock Co., Inc., Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of the Record. Petition to Review a Decision of The Tax Court of the United States.

Filed November 1, 1948.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
For the Ninth Circuit

No. 12080

BASALT ROCK CO., INC.,
Petitioner on Review,

vs.

GEORGE J. SCHOENEMAN, Commissioner of Internal Revenue,
Respondent on Review.

STATEMENT OF POINTS ON WHICH PETITIONER INTENDS TO RELY

Basalt Rock Co., Inc., Petitioner herein, makes the following statement of the points on which it intends to rely upon the petition for review herein:

1. The Tax Court erred in failing to hold that the phrase "corporation surtax net income, computed under section 15" in section 710(a)(1)(B) of the Internal Revenue Code refers to the specific corporation surtax net income computed under section 15 of Chapter 1 on which the surtax provided in Chapter 1 is imposed.

2. The Tax Court erred in failing to hold that the so-called 80 per cent limitation prescribed in section 710(a)(1)(B) on the amount of excess profits tax must be determined by using the regular method of accounting applicable in determining the taxpayer's surtax net income under Chapter 1.

3. The Tax Court erred in holding that the per-

centage of completion method of accounting elected by the taxpayer with respect to its long-term contracts applied in the determination of the taxpayer's corporation surtax net income computed under Chapter 1 for purposes of section 710(a)(1)(B).

4. The Tax Court erred in holding that the taxpayer for the year 1942 had two corporation surtax net incomes computed without regard to section 26(e), one computed under section 15 for the purposes of the surtax under Chapter 1, and the other computed under section 710(a)(1)(B) for the purposes of the excess profits tax.

5. The Tax Court erred in holding that said election under section 736(b) required the use of the elected method of accounting for every purpose of the excess profits tax.

6. The Tax Court erred in failing to hold that the percentage of completion method of accounting elected applied only to the determination of the excess profits net income on which the excess profits tax is computed under section 710(a)(1)(A).

7. The Tax Court erred in failing to hold that section 710(a)(1)(A) and section 710 (a)(1)(B) provide alternative and mutually exclusive methods of computing the taxpayer's excess profits tax liability.

8. The Tax Court erred in failing to hold that section 710(a)(1)(B) prescribes a computation of the excess profits tax wholly divorced from and independent of all other excess profits tax provisions contained in subchapter (e) of Chapter 2.

9. The Tax Court erred in construing section

710(a)(1)(B) as providing for a computation of income instead of a computation of tax.

10. The Tax Court erred in holding that the application of the elected method of accounting in computing the excess profits tax under section 710 (a)(1)(B) was required by a rule of consistency.

11. The Tax Court erred in failing to hold that there is no consistency required between section 710 (a)(1)(A) and section 710(a)(1)(B), since these sections are basically inconsistent with each other.

12. The Tax Court erred in failing to hold that all of the factors of computation of tax prescribed in section 710(a)(1)(B) must be computed on a consistent basis, namely, the use of the completed contract method of accounting for long-term contracts.

13. The Tax Court erred in holding that the Commissioner's regulation prescribing the use of the percentage of completion method elected under section 736(b) in determining corporation surtax net income for the purposes of section 710(a)(1)(B) is valid.

14. The Tax Court erred in failing to hold that the taxpayer's excess profits tax for the year 1942 must be computed by subtracting its normal tax and surtax liability from 80 per centum of the amount of $821,086.11.

15. The Tax Court erred in holding that the taxpayer's excess profits tax for the year 1942 should be computed by subtracting its normal tax and its surtax liability from 80 per centum of the amount of $2,120,523.10.

16. The Tax Court erred in ordering and deciding that there is due from the taxpayer for the year 1942 a deficiency in excess profits tax in the amount of $355,342.21.

17. The Tax Court erred in failing to determine and decide that there is due to taxpayer an overpayment of excess profits tax for the year 1942 in the amount of $935,575.38.

Dated, San Francisco, California, November 9, 1948.

/s/ SIGVALD NIELSON,

/s/ HARRY R. HORROW,

Attorneys for Petitioner on Review.

[Endorsed]: Filed November 10, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

DESIGNATION OF PARTS OF RECORD NECESSARY FOR CONSIDERATION

Basalt Rock Co., Inc., Petitioner herein, designates as necessary for the consideration of the points relied on:

1. The whole of the record certified by the Clerk of the Tax Court of the United States;
2. Stipulation for consideration of exhibits in form as certified;
3. Order for consideration of exhibits in form as certified.

Dated, San Francisco, California, Nov. 9, 1948.

/s/ SIGVALD NIELSON,
/s/ HARRY R. HORROW,
Attorneys for Petitioner on Review.

(Affidavit of Service attached.)

[Endorsed]: Filed November 10, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

STIPULATION FOR CONSIDERATION OF EXHIBITS IN FORM AS CERTIFIED

Basalt Rock Co., Inc., Petitioner, and George J. Schoeneman, Commissioner of Internal Revenue, Respondent, upon the petition on file herein for review of the decision of the Tax Court of the United States, hereby stipulate that the following exhibits need not be printed as part of the record,

but may be considered in the form certified by the Clerk of the Tax Court of the United States, and in such form shall constitute a part of the record on review:

Petitioner's Exhibit 1. United States corporation income and declared value excess profits tax return for calendar year 1942 filed by Basalt Rock Company, Inc.;

Petitioner's Exhibit 2. United States corporation excess profits tax return for calendar year 1942 filed by Basalt Rock Company, Inc.

Said exhibits are very voluminous and neither of said exhibits can feasibly be reproduced by printing, and for that reason the printing of said exhibits should be dispensed with.

Dated November 5th, 1948.

/s/ SIGVALD NIELSON,

/s/ HARRY R. HORROW,
Attorneys for Petitioner.

/s/ THERON L. CAUDLE,
Assistant Attorney General.
Attorney for Respondent.

[Endorsed]: Filed November 12, 1948. Paul P. O'Brien, Clerk.

[Title of U. S. Court of Appeals and Cause.]

ORDER FOR CONSIDERATION OF EXHIBITS IN FORM AS CERTIFIED

Upon the stipulation of petitioner and respondent on file herein, and good cause appearing therefor, it is hereby Ordered that Petitioner's Exhibit 1 and Petitioner's Exhibit 2 need not be printed as part of the record but may be considered in the form certified by the Clerk of the Tax Court of the United States, and in such form shall constitute a part of the record on appeal.

Dated, San Francisco, California, November 10, 1948.

/s/ WILLIAM DENMAN,
Chief Judge of the United States Court of Appeals for the Ninth Circuit.

(Acknowledgment of Service.)

[Endorsed]: Filed November 12, 1948. Paul P. O'Brien, Clerk.